

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
Denver, Colorado**

**FINANCIAL STATEMENT  
June 30, 2002 and 2001**

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Deputy State Auditor

*Dianne Ray*  
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**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND**

**FINANCIAL AUDIT**

June 30, 2002

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<b>Report Summary.....</b>	<b>1</b>
<b>Recommendation Locator .....</b>	<b>3</b>
<b>FINANCIAL AUDIT REPORT SECTION</b>	
<b>Description of the Colorado Student Obligation Bond Authority Prepaid Tuition Fund .....</b>	<b>4</b>
<b>FINDINGS AND RECOMMENDATIONS .....</b>	<b>5</b>
<b>PREPAID TUITION FUND</b>	
<b>Independent Auditor’s Report.....</b>	<b>7</b>
<b>Management’s Discussion and Analysis .....</b>	<b>9</b>
<b>Prepaid Tuition Fund Statement of Net Assets.....</b>	<b>14</b>
<b>Prepaid Tuition Fund Statement of Revenues, Expenses and     Changes in Net Assets.....</b>	<b>15</b>
<b>Prepaid Tuition Fund Statement of Cash Flows.....</b>	<b>16</b>
<b>Prepaid Tuition Fund Notes to Financial Statement.....</b>	<b>18</b>
<b>Independent Auditor’s Report on Compliance and on Internal     Control Over Financial Reporting Based on Audit of     Financial Statements Performed in Accordance With     Government Auditing Standards .....</b>	<b>31</b>

**Members of the Legislative Audit Committee:**

This report contains the results of the financial audit of the Prepaid Tuition Fund of the Colorado Student Obligation Bond Authority as of June 30, 2002. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of the departments, institutions and agencies of State government. The report presents our findings and recommendations and the responses of the Prepaid Tuition Fund of the Colorado Student Obligation Bond Authority.

*Clifton Henderson LLP*

Greenwood Village, Colorado  
November 4, 2002

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## **REPORT SUMMARY**

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### **COLORADO STUDENT OBLIGATION BOND AUTHORITY PREPAID TUITION FUND FINANCIAL AUDIT FISCAL YEAR ENDED JUNE 30, 2002**

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### **Purpose and Scope**

The Office of the State Auditor, State of Colorado engaged Clifton Gunderson LLP to conduct the financial audit of the Colorado Student Obligation Bond Authority (Authority) Prepaid Tuition Fund (Prepaid Tuition Fund) for the fiscal year ended June 30, 2002. Clifton Gunderson LLP performed this 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.

The purpose and scope of our audit was to express an opinion on the Prepaid Tuition Fund financial statements of the Authority as of the fiscal year ended June 30, 2002.

### **Audit Opinions and Reports**

We expressed an unqualified opinion on the Authority's Prepaid Tuition Fund financial statement, as of and for the fiscal year ended June 30, 2002.

### **Summary of Key Findings and Recommendations**

#### **Finding No. 1 – Strategic Plan**

The Authority was to develop a strategic plan to address the lack of self-sufficiency of the Prepaid Tuition Fund. We were to review the plan to see if it includes the Authority's definition of "financial soundness" for the Fund, including benchmarks for determining financial soundness and a timeframe for meeting these benchmarks.

The Authority has established its strategic plan that addresses the measures and criteria as well as the timeframes for evaluating the financial soundness of the Prepaid Tuition Fund.

There were no findings or recommendations reported for the year ended June 30, 2001.

## Required Communication

*Management Judgements and Accounting Estimates.* The Fund records a significant accounting estimate of financial data which is the actuarially determined net present value of education expenses that will be paid in future years to students when they attend the college or university of their choice.

*Audit Adjustments.* Three audit adjustments were made during the completion of fieldwork.

The first adjustment was to increase contracts and benefits payable by \$63,000 due to a revised actuarial report.

The second adjustment was to remove royalty receivable/income of \$98,500 from Prepaid Tuition Fund and reflect the amount in the Administrative Fund of the Student Loan Program Funds.

The third adjustment was made to record additional salaries, benefits and general and administrative expenses of \$155,000 resulting from a change in the allocation of direct and indirect costs.

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



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**DESCRIPTION OF THE  
COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND**

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**Organization**

The Colorado General Assembly established a student obligation bond program, a post secondary education expense program, and a college savings program, which are administered by the Colorado Student Obligation Bond Authority. The programs assist residents in meeting the expenses incurred in availing themselves of higher education opportunities.

**Colorado Prepaid Tuition Fund**

The Prepaid Tuition Fund was established in 1997 to provide families with an opportunity to save for future college education expenses. The Prepaid Tuition Fund offers an annual enrollment period for purchasers to buy prepaid tuition contracts. The Prepaid Tuition Fund offers certain federal and state tax advantages to investors and is designed to keep pace with average tuition inflation in Colorado. A purchaser buys tuition units based on current average tuition levels and the investment is valued and paid out at the level of average tuition at the time of payout. A purchaser can use amounts paid from the Prepaid Tuition Fund to pay for eligible expenses at private and public colleges, universities and vocational schools throughout the United States.

The Colorado Constitution and other State laws prohibit the State from providing its full faith and credit to obligations of other entities, such as the Prepaid Tuition Fund. As a result, payments from the Prepaid Tuition Fund are not guaranteed in any way by the State, and are not considered to have created a debt or obligation of the State. Such payments are limited obligations, payable from the Prepaid Tuition Fund, but not from the other assets of the Authority. In accordance with State law, if it is determined that the Prepaid Tuition Fund is not actuarially sound as determined by an annual actuarial valuation, the Authority may direct the distribution of available assets. If it is determined that the Prepaid Tuition Fund is not financially sound as determined by an annual audit, then the Prepaid Tuition Fund may discontinue permanently or for a period of time may suspend that particular aspect of the Prepaid Tuition Fund and the execution of additional contracts.



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## FINDINGS AND RECOMMENDATIONS

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In planning and performing our audit of the financial statements of the Colorado Student Obligation Bond Authority (the Authority) for the year ended June 30, 2002, we considered the Authority's internal control 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. Our consideration of the internal control was only a part of our overall audit plan and was not intended to be a complete review of all of the Authority's accounting procedures, therefore, it would not necessarily disclose all reportable conditions or other comments for improvement. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

As a result of the procedures described above, we have the following comment and recommendation for improvement.

### **FINDING NO. 1 – Strategic Plan**

The Prepaid Tuition Fund is dependent upon a positive return on its investments, growth and/or future contributions from the Authority to meet its obligations. Statutes require that the Authority determine the actuarial soundness of the Fund. According to Section 23-3.1-206.7(5)(d), C.R.S., the Authority is required to contract with a private consultant to perform an actuarial evaluation of the Prepaid Tuition Fund. If the Authority determines that the Fund is not actuarially sound, the Authority may direct the State Treasurer to distribute the available assets in a manner permitted by state law. At the end of the fiscal year 2002, the Authority transferred \$3.75 million to the Prepaid Tuition Fund from the Administrative Fund, in order to maintain actuarial soundness. For the three months subsequent to June 30, 2002, additional investment losses in the Prepaid Tuition Fund amounted to approximately \$3.5 million.

Under Section 23-3.1-206.7(8), C.R.S., the Authority must determine the financial soundness of the Prepaid Tuition Fund. If the Authority determines that the Fund is not financially sound, the Authority may discontinue permanently or for a period of time, the prepaid expense program or a particular aspect of the program. Statutes do not define and the Authority has not established a definition for financial soundness.

In order to assess the status of the Fund and determine appropriate actions to be taken, the Authority should work with its Board of Directors to develop a strategic plan. This plan should describe key measures and criteria that will be used in evaluating the “financial soundness” of the Fund, including timeframes for evaluating the financial soundness.

## **RECOMMENDATION**

We recommend that the Authority work with the Board of Directors to establish a strategic plan for the Prepaid Tuition Fund that:

- A. Describes key measures and criteria that will be used in evaluating the financial soundness of the Fund.
- B. Establishes key timeframes to periodically evaluate the financial soundness of the Fund.

## **AUTHORITY’S RESPONSE**

The Authority partially agrees with the finding. The Authority has established its strategic plan that addresses the measures and criteria as well as the timeframes for evaluating the financial soundness of the Fund as follows:

The Board of Directors, in conjunction with the Executive Director, evaluates the financial status of the Prepaid Tuition Fund quarterly. In addition, the overall “financial soundness” is evaluated on an annual basis. This evaluation is based on the professional judgment of the Executive Director and the Board of Directors, and is dependent on a wide variety of factors. One of the key elements used in evaluating the Fund’s status is the annual actuarial report prepared by Milliman USA. The conclusions reached in this report as well as business factors deemed critical in the Board’s professional judgment are discussed and reviewed. Based upon this discussion, the Board determines the Fund’s overall long-term financial viability.

In conjunction with the annual assessment of the Fund’s financial soundness for the year ended June 30, 2002, the Board of Directors and Executive Director concluded that certain changes to the Fund’s structure and financing were required. At the November 12 meeting, the Board made the following decisions:

- Indefinitely close the Fund to new accounts
- Revise cancellation terms after February 20, 2003
- Seek financial support from the State to the extent needed to meet future obligations
- If State funding is not provided, then the Fund benefits would be capped at no more than 5.5% increase in tuition value per year for future years.

A letter describing the changes was sent to all of the Fund participants November 20, 2002. The Executive Director and the Board intend to update their evaluation of the Fund after the February deadline and the 2003 legislative session.

## Independent Auditor's Report

Members of the Legislative Audit Committee:

We have audited the accompanying statement of net assets of the Colorado Student Obligation Bond Authority, (a division of the Department of Higher Education, State of Colorado) Prepaid Tuition Fund as of June 30, 2002 and 2001, and the related 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 Colorado Student Obligation Bond Authority, Prepaid Tuition Fund'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 of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 – Organization and Summary of Significant Accounting Policies, the financial statements of the Prepaid Tuition Fund are intended to present the financial position, and results of operations and cash flows for only that portion of the financial reporting entity of the Department of Higher Education, State of Colorado that is attributable to the transactions of the Colorado Student Obligation Bond Authority, Prepaid Tuition Fund.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Colorado Student Obligation Bond Authority, Prepaid Tuition Fund as of June 30, 2002 and 2001, and the results of its operations and its 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 November 4, 2002, on our consideration of the Colorado Student Obligation Bond Authority, Prepaid Tuition Fund'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 internal 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 audit.

The Prepaid Tuition Fund has incurred substantial investment losses during the two years ended June 30, 2002 and 2001. During the year ended June 30, 2002, the Authority contributed \$3.75 million to the Prepaid Tuition Fund and forgave \$118,000 of computer utilization charges to mitigate the investment losses and provide the Prepaid Tuition Fund sufficient assets to remain actuarially sound. However, as of June 30, 2002, the Prepaid Tuition Fund only had net assets of \$629,000 representing only .7% of its obligations. For the three months subsequent to June 30, 2002, investment losses amounted to approximately \$3.5 million. The Prepaid Tuition Fund is dependent upon a positive return on its investments, growth and/or future contributions from the Authority to meet its obligations. See Notes 11 and 12 in Notes to Financial Statements.

The Colorado Student Obligation Bond Authority, Prepaid Tuition Fund adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as of July 1, 2001. This results in a change in the format and content of the financial statements as of and for the fiscal years ended June 30, 2002 and 2001.

The Management's Discussion and Analysis (MD&A) on pages 9 to 13, 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.

*Clifton Henderson LLP*

Greenwood Village, Colorado  
November 4, 2002

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2002 AND 2001**

This section of the Prepaid Tuition Fund's financial statements is a discussion and analysis of the financial performance of the Prepaid Tuition Fund for the years ended June 30, 2002 and 2001. The Prepaid Tuition Fund is a qualified state tuition program pursuant to Internal Revenue Code (IRC) Section 529. The Colorado Student Obligation Bond Authority (Authority), a division of the Department of Higher Education of the State of Colorado administers the Prepaid Tuition Fund, the Student Loan Program Funds and the Scholars Choice Fund. The Prepaid Tuition Fund is presented as a proprietary fund in the State of Colorado Comprehensive Annual Financial Report. The Authority's Board of Directors (Board) approves the annual budget and the investment policy of the Prepaid Tuition Fund. Management of the Authority is responsible for the financial statements, footnotes and this discussion. The management's discussion and analysis should be read in conjunction with the Fund's financial statements.

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The Authority is presenting financial statements for its enterprise funds to include Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows.

**Overview of the Financial Statement**

This annual report contains two sections – management's discussion and analysis (this section) and the basic financial statements. The basic financial statements include a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets and a Statement of Cash Flows.

The Statement of Net Assets presents information on all of the Prepaid Tuition Fund's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in the net assets may serve as a useful indicator of whether the financial position of the Prepaid Tuition Fund is improving or deteriorating.

The Statement of Revenues, Expenses and Changes in Net Assets presents information that reflects how the Prepaid Tuition Fund's net assets changed during the past year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.

The Statement of Cash Flows reports the Prepaid Tuition Fund's cash flows from operating, non-capital financing, capital and related financing, and investing activities.

**Analysis of Financial Activities**

The Prepaid Tuition Fund was designed to provide families with an opportunity to save for future college education expenses. The Prepaid Tuition Fund offers an enrollment period for purchasers to buy prepaid tuition contracts. The Prepaid Tuition Fund offers certain federal and State tax advantages to investors and is designed to keep pace with average tuition inflation in Colorado. A purchaser buys tuition units based on current average tuition levels and the investment is valued and paid out at the level of average tuition at the time of payout. A purchaser can use amounts paid from the Prepaid Tuition Fund to pay for eligible expenses at private and public colleges, universities and vocational schools throughout the United States.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2002 AND 2001**

**Analysis of Financial Activities (continued)**

The Authority utilizes an Administrative Fund (within the Student Loan Program Funds of the Authority) for payment of general and administrative expenses and other activities necessary to fulfill the purposes of the various funds, including the Prepaid Tuition Fund. These expenses and activities have been allocated to the respective Funds.

**Comparison of Current Year Results to Prior Year**

*Condensed Statement of Net Assets as of June 30,*  
(dollar amounts expressed in thousands)

	<u>2002</u>	<u>2001</u>
Cash and investments	\$64,662	\$51,901
Advance payment contract receivables	27,065	28,618
Interest receivable and capital assets, net	<u>338</u>	<u>2,191</u>
Total assets	<u>92,065</u>	<u>82,710</u>
Accounts payable, accrued expenses and amounts due to Student Loan Program Funds	473	1,988
Contracts and benefits payable	<u>90,963</u>	<u>79,715</u>
Total liabilities	<u>91,436</u>	<u>81,703</u>
Net assets restricted for contracts and benefits	<u>\$ 629</u>	<u>\$ 1,007</u>

Cash and investments increased by approximately \$12.8 million, primarily from account holder payments and a transfer from the Administrative Fund within the Student Loan Program Funds of the Authority. The transfer of \$3.75 million from the Administrative Fund within the Student Loan Program Funds was the result of the Board's action to assist the Prepaid Tuition Fund meet its future obligations. The Administrative Fund has no obligation to make contributions to the Prepaid Tuition Fund in the future. Account holder payments came from new lump sum payments and monthly installment payments.

Advance payment contract receivables decreased by approximately \$1.6 million. The decrease was a result of monthly installment payments, accounts refinancing from installment to paid in full status, cancellations, and rollovers being greater than the amount added for new installment contracts during the year.

The unamortized cost of software development costs (capital assets) of \$1.9 million was transferred to the Administrative Fund within the Student Loan Program Funds of the Authority at the beginning of the year. In conjunction with this transfer, the Prepaid Tuition Fund eliminated an equal amount due to the Student Loan Program Funds.

The increase to contracts and benefits payable of \$11.2 million was from increases in new contract liabilities of approximately \$6.7 million and the actuarial increase of existing contracts and benefits expense of \$3.5 million.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2002 AND 2001**

**Comparison of Current Year Results to Prior Year (continued)**

*Condensed Statement of Revenues, Expenses and Changes in Net Assets for the Years Ended June 30,*  
(dollar amounts expressed in thousands)

	<b><u>2002</u></b>	<b>2001</b>
Contract income	<b>\$ 1,951</b>	\$ 1,736
Net investment income and realized gains (losses)	<b>(6,174)</b>	2,710
Net appreciation (depreciation) in fair value of investments	<b><u>4,645</u></b>	(7,741)
Total operating revenues	<b><u>422</u></b>	<b>(3,295)</b>
Contracts and benefits expense	<b>3,536</b>	4,406
Other expenses	<b><u>1,132</u></b>	<u>1,228</u>
Total operating expenses	<b><u>4,668</u></b>	<u>5,634</u>
Net operating loss before transfers	<b>(4,246)</b>	(8,929)
Transfer from Student Loan Program Funds	<b>3,868</b>	-
Net assets, beginning of year	<b><u>1,007</u></b>	<u>9,936</u>
Net assets, end of year	<b><u>\$ 629</u></b>	<b>\$ <u>1,007</u></b>

Contract income increased by \$215,000 due primarily to an increase in interest on advance payment contract receivables. Contract income will fluctuate from year to year based on the number of installment contracts and payments made. See Note 1 in the notes to the financial statements.

Net investment income decreased due to a combination of factors as follows:

Interest income	\$ 1,322	\$ 991
Dividend income	134	212
Realized gain (loss) on investments	(7,630)	<u>1,507</u>
Net investment income and realized gains (losses)	<b>\$ (6,174)</b>	<b>\$ <u>2,710</u></b>

US Treasury Inflation Protection Securities interest income increased by \$331,000 to \$1.3 million due to the purchase of an additional \$6.1 million in securities in March of 2001. Therefore, a full year of interest on this portion of the investments was included in 2002 as opposed to only a few months in 2001. Dividend income was lower by \$78,000 due to market conditions. During the fiscal year ended June 30, 2002, a change in the investment asset allocation was approved by the Board. This change required the sale of certain mutual funds at a realized loss in the current year of \$7.6 million due to market conditions. Proceeds from the sale are being reinvested on the dollar cost averaging method using the new asset allocation of 5% in small capitalization stock funds, 15% in international capitalization stock funds, 40% in United States Treasury Inflation Protection Securities and 40% large capitalization stock funds. The \$1.5 million dollar gain in fiscal year end 2001 represents capital gain distributions by certain mutual funds. At June 30, 2002, the new mutual funds and the US Treasury Inflation Protection Securities had an increase in fair market value of approximately \$4.7 million.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2002 AND 2001**

**Comparison of Current Year Results to Prior Year (continued)**

For the fiscal year ended June 30, 2002, the Prepaid Tuition Fund used a tuition growth assumption of 5% for the next four years and 5.5% per annum thereafter, instead of 5.5% for all future years. For prior fiscal years, the actuarial assumptions for tuition growth had been 5.5% for all future years. The Prepaid Tuition Fund over the last five years has seen tuition growth at 1.3%, 2.6%, 3.3%, 4.6%, and 6.7% for the years starting August 1, 1998, 1999, 2000, 2001, and 2002, respectively. Tuition is set by the legislature and the governing boards of the Colorado Public institutions of higher education. The change in the estimate for calculating the Contracts and Benefits Payable is the primary reason for the reduction in contracts and benefits expense in 2002 from 2001 of approximately \$637,000. Contracts that were refinanced, cancelled, and rolled over to other qualified Section 529 plans further reduced the contracts and benefits expense by approximately \$233,000.

The Authority has reduced the operating expenses of the Prepaid Tuition Fund by \$96,000 from last year and continues to reduce spending. With the transfer of the software development asset, the Administrative Fund within the Student Loan Program Funds charges the Prepaid Tuition Fund its share of computer utilization charges based on actual usage. For 2002, computer charges were approximately \$118,000. The Board forgave these computer charges for the year ended June 30, 2002.

**Capital Assets**

The Prepaid Tuition Fund's investment in capital assets decreased by \$1.9 million to no capital assets at June 30, 2002. The unamortized software development costs of \$1.9 million were transferred to the Administrative Fund within the Student Loan Program Funds of the Authority at the beginning of the year. In conjunction with this transfer, the Prepaid Tuition Fund eliminated an equal amount due to the Student Loan Program Funds. The changes in capital assets were as follows:

	June 30, 2001	<u>Deletions</u>	<u>Depreciation &amp; Amortization</u>	June 30, 2002
Recordkeeping software	\$ 1,859	\$ 1,859	\$ -	\$ -

**Economic Factors and Future Years' Rates**

- ❖ As of August 1, 2002, the Prepaid Tuition Fund has suspended execution of new contracts until such time as the Board deems appropriate. Management is evaluating restructuring the Prepaid Tuition Fund.
- ❖ Effective August 1, 2002, average tuition increased from \$24.64 per unit to \$26.29 per unit, a 6.7% increase. The Prepaid Tuition Fund has projected tuition increases to be 5% per annum for each of the next four years and 5.5% per annum thereafter. Since inception, on average, tuition has increased 4% per year.
- ❖ Future stock and bond market returns are all estimated based on past performance and rates of return.



**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2002 AND 2001**

**Economic Factors and Future Years' Rates (continued)**

- ❖ On January 1, 2002, the Economic Growth and Tax Relief Act of 2001 was signed into law. This law excludes from federal taxable income the earnings on any withdrawals that are used for qualified higher education expenses as defined in Section 529 of the Internal Revenue Code. This exclusion will automatically be repealed December 31, 2010, after which earnings on withdrawals will again be subject to federal income tax.
  
- ❖ During the year ended June 30, 2002, the Administrative Fund within the Student Loan Program Funds contributed \$3.75 million to the Prepaid Tuition Fund and forgave \$118,000 of computer utilization charges. This is considered a one time contribution and may not be available in future years. If it is determined by the Authority that the Prepaid Tuition Fund is not actuarially sound, as determined by an annual actuarial valuation, the Authority may direct the distribution of available assets. If it is determined that the Prepaid Tuition Fund is not financially sound, then the Prepaid Tuition Fund may discontinue permanently or for a period of time may suspend that particular aspect of the Prepaid Tuition Fund and the execution of additional contracts. For the three months ended September 30, 2002, the Fund incurred investment losses of approximately \$3.5 million.

**Requests for Information**

This report is designed to provide a general overview of the Prepaid Tuition Fund's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Douglas R. Angell, Chief Financial Officer, CollegeInvest, 1801 Broadway, Suite 1300, Denver, CO 80202.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
STATEMENT OF NET ASSETS  
JUNE 30, 2002 AND 2001  
(dollar amounts expressed in thousands)**

	<u>2002</u>	<u>2001</u>
<b>Assets</b>		
Cash deposits	\$ 9,836	\$ 1,350
Investments	54,826	50,551
Advance payment contract receivables	27,065	28,618
Interest and other receivables	338	332
Capital assets, net	<u>-</u>	<u>1,859</u>
<b>Total assets</b>	<b><u>92,065</u></b>	<b><u>82,710</u></b>
<b>Liabilities</b>		
Accounts payable and accrued expenses	126	87
Due to Student Loan Program Funds	347	1,901
Contracts and benefits payable	<u>90,963</u>	<u>79,715</u>
<b>Total liabilities</b>	<b>91,436</b>	<b>81,703</b>
Net assets restricted for contracts and benefits	<u>629</u>	<u>1,007</u>
<b>Total net assets</b>	<b><u>\$ 629</u></b>	<b><u>\$ 1,007</u></b>

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

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
STATEMENT OF REVENUES, EXPENSES AND  
CHANGES IN NET ASSETS  
FOR THE YEARS ENDED JUNE 30, 2002 AND 2001  
(dollar amounts expressed in thousands)**

	<u>2002</u>	<u>2001</u>
<b>Operating revenues:</b>		
Contract income	\$ 1,951	\$ 1,736
Net investment income and realized gains (losses)	(6,174)	2,710
Net appreciation (depreciation) in fair value of investments	<u>4,645</u>	<u>(7,741)</u>
<b>Total operating revenues</b>	<u>422</u>	<u>(3,295)</u>
<b>Operating expenses:</b>		
Contracts and benefits expense	3,536	4,406
General and administrative expenses	562	164
Marketing	210	396
Salaries and benefits	189	251
Professional services	171	159
Amortization of capital assets	<u>-</u>	<u>258</u>
<b>Total operating expenses</b>	<u>4,668</u>	<u>5,634</u>
<b>Change in net assets before transfers</b>	<b>(4,246)</b>	<b>(8,929)</b>
<b>Transfer from the Student Loan Program Funds</b>	<u>3,868</u>	<u>-</u>
<b>Change in net assets</b>	<b>(378)</b>	<b>(8,929)</b>
<b>Net assets, beginning of year</b>	<u>1,007</u>	<u>9,936</u>
<b>Net assets, end of year</b>	<u>\$ 629</u>	<u>\$ 1,007</u>

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

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
STATEMENT OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2002 AND 2001  
(dollar amounts expressed in thousands)**

	2002	2001
<b>Cash Flows from Operating Activities:</b>		
Cash receipts from advance payment contracts	\$ 13,481	\$ 9,032
Cash distributions for advance payment contracts	(2,156)	(3,044)
Cash payments to suppliers for goods and services	(569)	(1,158)
Cash payments to employees for service	<u>(189)</u>	<u>(251)</u>
<b>Net cash provided by operating activities</b>	<b><u>10,567</u></b>	<b><u>4,579</u></b>
<b>Cash Flows from Investing Activities:</b>		
Redemptions (purchases) of investments	(7,802)	(12,649)
Income received from investments	<u>1,853</u>	<u>2,605</u>
<b>Net cash used by investing activities</b>	<b><u>(5,949)</u></b>	<b><u>(10,044)</u></b>
<b>Cash Flows from Non-Capital Financing Activities:</b>		
Transfers from Student Loan Program Funds	<u>3,868</u>	<u>-</u>
<b>Net cash provided by non-capital financing activities</b>	<b><u>3,868</u></b>	<b><u>-</u></b>
<b>Cash Flows from Capital Financing Activities:</b>		
Purchases of other assets	<u>-</u>	<u>(118)</u>
<b>Net cash (used) in capital financing activities</b>	<b><u>-</u></b>	<b><u>(118)</u></b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>8,486</b>	<b>(5,583)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b><u>1,350</u></b>	<b><u>6,933</u></b>
<b>Cash and cash equivalents, end of period</b>	<b><u>\$ 9,836</u></b>	<b><u>\$ 1,350</u></b>

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

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**STATEMENT OF CASH FLOWS (continued)**  
**FOR THE YEARS ENDED JUNE 30, 2002 AND 2001**  
(dollar amounts expressed in thousands)

	2002	2001
<b>Reconciliation of net income to net cash provided by operating activities:</b>		
Change in net assets before transfers	\$ (4,246)	\$ (8,929)
<b>Items reflected as investing activities:</b>		
Income received from investments	(1,853)	(2,605)
Loss on sale of investments	7,965	-
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Net (appreciation) depreciation of fair value of investments	(4,438)	7,761
Amortization of other assets	-	258
<b>Changes in operating assets and liabilities:</b>		
Advance payment contract receivables	1,595	6,851
Interest and other receivables	(6)	(105)
Accounts payable and accrued expense	39	(140)
Due to Student Loan Program Funds	263	(290)
Contracts and benefits payable	11,248	1,778
<b>Net cash provided by operating activities</b>	<b>\$ 10,567</b>	<b>\$ 4,579</b>

**Noncash transactions:**

The change in Due to Student Loan Program Funds does not include the elimination of the payable exchanged for recordkeeping software of \$1.9 million.

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

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT**  
**JUNE 30, 2002 AND 2001**

**1. Organization and Summary of Significant Accounting Policies:**

Pursuant to the Colorado Revised Statutes 23-3.1-2 and 23-3.1-3, as amended, the Colorado Student Obligation Bond Authority (Authority) is a division of the Colorado Department of Higher Education (Department) of the State of Colorado. The Executive Director of the Department (Executive Director) has responsibility for oversight and management of the Authority. In addition, the Authority has a nine-person Board of Directors (Board) designated by the Governor and approved by the State Senate to serve four-year terms.

The Colorado General Assembly established a student obligation bond program (Student Loan Program Funds), a post secondary education expense program (Prepaid Tuition Fund), and a college savings program (Scholars Choice Fund) which are administered by the Authority. The mission of the Authority is to provide innovative, quality financial resources and services that enable all Coloradans to pursue higher education. The operations of the programs of the Authority are accounted for under generally accepted accounting principles. The Authority receives no grants from, and is not otherwise financially assisted by, the State or any local government of the State. The Authority is an enterprise under Section 20, Article X of the Colorado Constitution.

*Prepaid Tuition Fund*

The Prepaid Tuition Fund was established in 1997 to provide families with an opportunity to save for future college education expenses. The Prepaid Tuition Fund offers an annual enrollment period for purchasers to buy prepaid tuition contracts. The Prepaid Tuition Fund offers certain federal and State tax advantages to investors.

The Prepaid Tuition Fund is designed to keep pace with average tuition inflation in Colorado. A purchaser buys tuition units based on current average tuition levels and the investment is valued and paid out at the level of average tuition or an average minimum of 4% per year (when held until the first payout date), whichever is greater, at the time of payout. Average tuition is determined annually by the Prepaid Tuition Fund by adding (1) the sum of the applicable year's resident, undergraduate, general full-time tuition at all Colorado public four-year colleges and universities, to (2) the average full-time tuition at the State community colleges for that year. Full-time tuition equates to the tuition charged for the equivalent of fifteen credit hours for each of two semesters. The total of (1) and (2) above is then divided by the number of Colorado public four-year colleges and universities in existence at such time plus one for the State community colleges.

A purchaser sets a tuition unit goal for the portion of average tuition she or he wishes to buy based on her or his anticipated need to pay actual tuition and other eligible expenses, such as fees, books and supplies, and/or room and board. If a purchaser buys an amount equal to one year of average tuition and the student attends a school with tuition less than the average tuition, the difference may be used for other eligible expenses. If the student attends a college with tuition more than the average tuition, the student must pay the difference. A purchaser's investment is valued in dollars at the time of pay out based on average tuition or an average minimum of 4% per year (when held until the first payout date), whichever is greater, calculated at that time, regardless of whether the student attends an in-state or out-of-state college or university. The purchaser does not select a specific school at the time of investment. A purchaser can use amounts paid from the Prepaid Tuition Fund to pay for eligible expenses at private and public colleges, universities and vocational schools throughout the United States.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT (CONTINUED)**  
**JUNE 30, 2002 AND 2001**

**1. Organization and Summary of Significant Accounting Policies (continued):**

*Prepaid Tuition Fund (continued)*

A qualified withdrawal is a withdrawal made to pay qualified higher education expenses of the student. All withdrawals other than qualified withdrawals are considered non-qualified withdrawals. Non-qualified withdrawals are subject to a 10% penalty on earnings per Section 529 of the Internal Revenue Code. A non-qualified withdrawal is not subject to the 10% penalty only if the withdrawal is: (i) made on account of the death or disability of the student; (ii) made on account of a scholarship received by the student, to the extent that the withdrawal does not exceed the amount of the scholarship; or (iii) a non-taxable transfer to another account or to another Section 529 program for a different student who is a family member of the original student.

The Colorado Constitution and other State laws prohibit the State from providing its full faith and credit to obligations of other entities, such as the Prepaid Tuition Fund. As a result, payments from the Prepaid Tuition Fund are not guaranteed in any way by the State, and are not considered to have created a debt or obligation of the State. Such payments are limited obligations, payable from the Prepaid Tuition Fund, but not from the other assets of the Authority.

In accordance with the Colorado Revised Statutes 23-3.1-206.7(5)(d), if it is determined by the Authority that the Prepaid Tuition Fund is not actuarially sound, as determined by an annual actuarial valuation, the Authority may direct the distribution of available assets. If it is determined that the Prepaid Tuition Fund is not financially sound, then the Prepaid Tuition Fund may discontinue permanently or for a period of time may suspend that particular aspect of the Prepaid Tuition Fund and the execution of additional contracts. Likewise, if it is determined that an excess amount exists in the Prepaid Tuition Fund, the Authority would calculate the portion of such excess that would be attributable on a pro rata basis to each tuition unit. As of August 1, 2002, the Prepaid Tuition Fund has suspended execution of new contracts until such time as the Board deems appropriate. Management is reviewing all aspects of the Prepaid Tuition Fund to ensure that it is cost effective, efficient, and has a quality product.

**Reporting Entity:**

The Prepaid Tuition Fund was established to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent is that costs of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. Purchaser payments and the earnings thereon are invested to meet the obligations for future higher education expenses of a named student under each contract. The payment of general and administrative expenses and other activities of the Prepaid Tuition Fund necessary to fulfill its purposes are recorded within this fund. There are no other funds of the Authority combined with the Prepaid Tuition Fund in the accompanying financial statements. Thus, the accompanying financial statements are not intended to present the financial position, results of operations, and cash flows of the Authority as a whole in conformity with generally accepted accounting principles.

**Budgets and Budgetary Accounting:**

By statute, the Prepaid Tuition Fund is continuously appropriated through user charges. Therefore, the budget is not legislatively adopted and a Statement of Revenues and Expenses – Budget to Actual is not a required part of these financial statements. Total budgeted expenses for the Prepaid Tuition Fund for the fiscal year ended June 30, 2002 were \$4.8 million, compared to actual expenses of \$4.7 million.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT (CONTINUED)**  
**JUNE 30, 2002 AND 2001**

**1. Organization and Summary of Significant Accounting Policies (continued):**

**Budgets and Budgetary Accounting (continued):**

The Executive Director and the Board exercise oversight responsibilities, including budgetary and financial oversight.

**Basis of Accounting:**

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles and standards of the Governmental Accounting Standards Board (GASB). The Prepaid Tuition Fund has applied pronouncements issued on or before November 30, 1989 by the Financial Accounting Standards Board, the Accounting Principles Board, and the Committee on Accounting Procedure, except for pronouncements that conflict with or contradict those of the GASB.

The accrual basis of accounting is utilized by the Prepaid Tuition Fund. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period they are incurred.

The Prepaid Tuition Fund implemented the new financial reporting requirements of GASB No. 34 as of July 1, 2001.

**Cash and Cash Equivalents:**

The Prepaid Tuition Fund considers all cash, demand deposit accounts and State Treasurer's cash pool to be cash equivalents.

**Investments:**

Investments are carried at fair value, which are primarily determined based on quoted market prices at June 30, 2002 and 2001.

**Advance Payment Contract Receivables:**

Advance payment contract receivables are recorded at the contract base price. Contract income represents a 7.0% charge for paying over time on all installment contracts (an approximate effective rate of 6.78%).

**Capital Assets:**

Capital assets as of June 30, 2001 included costs for software development and were carried at cost, less accumulated amortization. Amortization was calculated using the straight-line method over ten years. During the fiscal year ended June 30, 2002, the Prepaid Tuition Fund transferred \$1.9 million of software development costs to the Administrative Fund within the Student Loan Program Funds of the Authority for the unamortized cost of the software. The Authority will charge each of its funds for use of the software based on its corresponding computer utilization. As of June 30, 2001, the Prepaid Tuition Fund was current on its payments for computer usage. For the fiscal year ended June 30, 2002, the Administrative Fund within the Student Loan Program Funds of the Authority forgave the computer usage charge of the Prepaid Tuition Fund of \$118,000 which is recorded as general and administrative expenses and a corresponding transfer from the Student Loan Program Funds.



**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT (CONTINUED)**  
**JUNE 30, 2002 AND 2001**

**1. Organization and Summary of Significant Accounting Policies (continued):**

**Compensated Absences:**

Compensated absences, known as general leave, include vacation and sick pay and are included in accounts payable and accrued expenses. Compensated absences are based on an employee's length of service and are earned ratably during the term of employment. Vested and accumulated general leave that is expected to be liquidated by employees of the Prepaid Tuition Fund is accrued and charged against current operations.

**Due to Student Loan Program Funds:**

As of June 30, 2001, the Board had authorized the Administrative Fund within the Student Loan Program Funds of the Authority to advance the Prepaid Tuition Fund monies for software development and for operating expenses. The advances for software development were to be repaid without interest through 2008. This obligation was eliminated on July 1, 2001 when the Prepaid Tuition Fund transferred the software development costs to the Administrative Fund within the Student Loan Program Funds. Advances for operating expenses are repaid quarterly without interest.

**Contracts and Benefits Payable/Expense:**

Contracts and benefits payable represent the actuarially determined net present value of education expenses that will be paid in future years to students when they attend the college or university of their choice. The contracts and benefits payable is adjusted and reflected as contracts and benefits expense for the effects of future tuition increases and contract cancellations.

**Transfers from the Authority:**

During the fiscal year ended June 30, 2002, the Administrative Fund within the Student Loan Program Funds transferred \$3.75 million as a contribution to the Prepaid Tuition Fund and forgave \$118,000 of computer utilization charges.

**Revenue Recognition:**

The Prepaid Tuition Fund utilizes the deposits method of accounting. Advance payment contracts are recorded gross with the cash or receivable offset by contracts and benefits payable with no effect on net income.

**Expense Limitation:**

The annual administrative expenses of the Prepaid Tuition Fund (excluding contracts and benefits expense and amortization of software costs) is limited by the Colorado Revised Statutes 23-3.1-206.7(5)(e)(I) to 1% of the contract commitment. During the fiscal year ended June 30, 2001, expenses incurred in connection with the administration of the Prepaid Tuition Fund exceeded the limitation by \$225,000. This excess was absorbed by the Administrative Fund within the Student Loan Program Funds. For the fiscal year ended June 30, 2002, the Prepaid Tuition Fund was in compliance with this requirement.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**1. Organization and Summary of Significant Accounting Policies (continued):**

**Reclassifications:**

Certain amounts in the June 30, 2001 financial statements have been reclassified to conform to the current year's presentation.

**Use of Estimates:**

The preparation of financial statements in conformity with generally accepted accounting principles 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 statement and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from these estimates.

**2. Cash Deposits and Investments:**

**Cash Deposits:**

All cash deposits are held by a bank as agent for the Prepaid Tuition Fund. Payments and cash receipts are deposited to demand deposit accounts daily. Monies in the demand deposit accounts are insured by federal depository insurance for the first \$100,000. Deposits in excess of the \$100,000 limit are collateralized subject to the provisions of the State's Public Deposit Protection Act (PDPA) for monies held within the State.

Cash deposits as of June 30 are as follows:

	<b>2002</b>	<b>2001</b>
	(dollar amounts expressed in thousands)	
State Treasurer's cash pool	\$ 9,815	\$ 1,307
Demand deposit accounts – insured by FDIC	21	43
<b>Total Cash Deposits</b>	<b>\$ 9,836</b>	<b>\$ 1,350</b>

The carrying amount and bank balance of demand deposit accounts was \$21,000 and \$21,000 as of June 30, 2002 and \$43,000 and \$43,000 as of June 30, 2001, respectively.

**Investment Authority:**

Under the Colorado Revised Statutes 23-3.1-216, the State of Colorado Treasury has responsibility for the investment of the Prepaid Tuition Fund's monies, based on the advice and the recommendation of the Board, and with the following investment limitations:

- The aggregate amount of monies invested in corporate stocks or corporate bonds, notes or debentures that are convertible into stock cannot exceed 60% of the market value of invested assets.
- No investment in common or preferred stock (or both) of any corporation can exceed 5% of the market value of invested assets.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**2. Cash Deposits and Investments (continued):**

**Investment Authority (continued):**

- The fund cannot acquire more than 5% of the outstanding stock or bonds of any single corporation.

The above limitations and the Prepaid Tuition Fund's diversification over several asset classes are intended to reduce the overall investment risk exposure. The Prepaid Tuition Fund has not exceeded any of these limitations as of June 30, 2002 and 2001.

**Investments:**

In accordance with GASB Statement No. 3, as amended by GASB Statement No. 31, investments are categorized into the following three categories of credit risk:

Category 1 --- Investments that are insured or registered or investments which are held by the Authority's agent in the Authority's name.

Category 2 --- Investments that are uninsured or unregistered which are held by an agent or trust department in the Authority's name.

Category 3 --- Investments that are uninsured or unregistered which are held by an agent or trust department but not in the Authority's name.

The Board approves the investment policy for the Prepaid Tuition Fund. Generally, investments include direct obligations of the U.S. government, money market funds and equity mutual funds. With respect to these investments, the Prepaid Tuition Fund is subject to market risk, which represents the exposure to changes in the market, such as a change in interest rates or a change in price or principal value of a security. Credit risk is the exposure to the default of the issuer of the investment securities.

Investments in mutual funds are not categorized because they are not evidenced by securities that exist in physical or book entry form. Investments are stated at fair value.

Investments as of June 30 are as follows:

	Category of Credit Risk			2002	2001
	No. 1	No. 2	No. 3	Total Fair Value	Total Fair Value
(dollar amounts expressed in thousands)					
U.S. government securities	\$ 28,015	\$ -	\$ -	\$ 28,015	\$ 26,462
Plus uncategorized investments -					
Mutual funds				26,236	23,994
Money market funds				575	95
<b>Total Investments</b>	<b>\$ 28,015</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 54,826</b>	<b>50,551</b>

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**3. Advance Payment Contract Receivables:**

Purchasers enter into advance payment contracts for a number of tuition units. The Prepaid Tuition Fund values and pays out tuition units based on future average tuition to the designated student when he or she attends a college of his or her choice. These contracts may be purchased with a one-time lump sum payment, a monthly payment plan, or a combination plan. The monthly payment plan allows the purchaser to determine the monthly payment amount and the number of payments the purchaser wishes to make. The combination plan allows the purchaser to begin paying with a lump sum payment and his or her first monthly payment, followed by subsequent monthly payments. Monthly payment plans are generally for full term (from the contract date until at least three months before the scheduled payout date), five years, or ten years. The full term monthly payment plan has a preset number of months based on the payout year. The full term monthly payment plans range from 33 months for payout year 2004 to 201 months for payout year 2018. Contracts for monthly payment plans generally provide for payment of a contract base price and a charge for paying over time (at an approximate effective rate of 6.78%). Advance payment contract receivables are \$27.1 million and \$28.6 million as of June 30, 2002 and 2001, respectively.

**4. Capital Assets:**

Capital assets as of June 30 are as follows:	2002	2001
	(dollar amounts expressed in thousands)	
Software development costs	\$ -	\$ 2,618
Less accumulated amortization	-	(759)
<b>Capital Assets, Net</b>	<b>\$ -</b>	<b>\$ 1,859</b>

During the fiscal year ended June 30, 2002, the unamortized cost of software development of \$1.9 million was transferred to the Administrative Fund within the Student Loan Program Funds of the Authority. In conjunction with this transfer, the Prepaid Tuition Fund eliminated an equal amount due to the Student Loan Program Funds.

**5. Contracts and Benefits Payable:**

The following table presents total contracts and benefits payable of the Prepaid Tuition Fund, including the obligation related to advance payment contract receivables, measured at the actuarial net present value (APV) of the future contracts and benefits expense. The valuation method reflects the present value of estimated contracts and benefits expenses that will be paid in future years and is adjusted for the effects of projected tuition increases and cancellations of certain contracts. Net assets represent assets available to meet the Prepaid Tuition Fund's contracts and benefits payable obligations. See the Actuarial Valuation Report of the Prepaid Tuition Fund as of June 30, 2002 for further information and details.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**5. Contracts and Benefits Payable (continued):**

As of June 30: 2002                      2001  
(dollar amounts expressed in thousands)

APV of Future Contracts and Benefits Payable \$ 90,963                      \$ 79,715

Total Assets Available for Future Contracts and Benefits Payable are as follows:

Cash deposits	\$ 9,836	\$ 1,350
Investments	54,826	50,551
Advance payment contract receivables	27,065	28,618
Interest receivable	338	332
Capital assets, net	-	1,859

Less

Accounts payable and accrued expenses	(126)	(87)
<u>Due to Student Loan Program Funds</u>	<u>(347)</u>	<u>(1,901)</u>

Total Assets Available for Future Contracts and Benefits Payable \$ 91,592                      \$ 80,722

Excess Assets \$ 629                      \$ 1,007

Excess Assets as a Percentage of Contracts and Benefits Payable 101%                      101%

The following assumptions developed by management were used in the actuarial valuation as of June 30, 2002 and 2001. These assumptions are based on historical data both for the State and national trends.

**Investment rates**                      The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash. Since inception the investment yield assumption has been 7.5% per annum. For the period from inception to June 30, 2002, the annualized yield on cash and investments has been 1.09% and the annualized yield on advance payment contract receivables has been 6.78%.

**Tuition increases**                      Tuition increases are based on the current best estimate of future tuition increases for Colorado public four-year colleges and universities in existence at such time plus the State community colleges. For the period from inception to June 30, 2002, the assumption for tuition increases had been 5.5%. Starting July 1, 2002, the tuition increases assumption will be 5.0% per year for four years and 5.5% per year thereafter. For the period from inception to June 30, 2002, the annualized tuition increase has been 4.0%.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**5. Contracts and Benefits Payable (continued):**

The following schedule of the estimated distribution of contracts and benefits payments does not convey the same information as the actuarial net present value of future contracts and benefits presented on the previous page. The actuarial net present value represents management's estimate of assets required today so that all participants will be paid in the future. The following schedule of the estimated distribution of contracts and benefits payments shows future benefit payments if future tuition increases at 5.0% per annum for each year for the next four years and 5.5% per annum thereafter. The schedule also assumes that any contract with less than 200 units pays out in one year, any contract with greater than 199.99 units and less than 300 units pays half of the units per year for two years, any contract with greater than 299.99 units and less than 400 units pays one third of the units per year for three years, and contracts with greater than 399.99 units pays one fourth of the units per year for four years.

	<u>Total</u>
	(dollar amounts expressed in thousands)
2003	\$ 2,625
2004	3,852
2005	5,377
2006	7,199
2007	7,859
2008-2012	49,218
2013-2017	55,360
2018-2022	27,106
2023-2027	<u>646</u>
Total Estimated Contracts and Benefits Distributions	<u><b>\$ 159,242</b></u>

**6. Retirement Plan:**

**Plan Description:**

Virtually all of the Authority's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer 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 and other divisions' 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 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.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**6. Retirement Plan (continued):**

**Plan Description (continued):**

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.

**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, the state contributed 9.9 percent (12.6 percent for state troopers and 13.5 percent for the Judicial Branch) of the employee's gross covered wages. Before January 1, 2002, 1.42 percent was allocated to the Health Care Trust Fund, and after January 1, 2002, 1.64 percent was allocated to the Health Care Trust Fund. Throughout the fiscal year, the amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker program (See Note 7 below.) The balance remaining after allocations to the Matchmaker program and the Health Care Trust Fund was allocated to the defined benefit plan.

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

The Authority's contributions on behalf of the Prepaid Tuition Fund to the three programs described above for the fiscal years ending June 30, 2002 and 2001 were \$10,000 and \$21,000, respectively. These contributions met the contribution requirement for each year.

**7. 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). The PERA Board sets the level of the match annually – based on the actuarial funding of the defined benefit pension plan. Two percent of gross salary plus 50 percent of any reduction in the overall contribution rate due to over funding of the pension plan was available for the match. PERA offers a voluntary 401k 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 403b plan. Members who contribute to any of these plans also receive the state match.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT (CONTINUED)**  
**JUNE 30, 2002 AND 2001**

**8. 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, the premium subsidy was \$115.00 for those with 20 years of service credit (\$230.00 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 an employer's contribution as discussed above in Note 6.

Monthly premium costs for participants depend on the health care plan selected, the number of persons covered, Medicare eligibility, and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured plans, and with health maintenance organizations providing services within Colorado. As of December 31, 2001 there were 34,235 participants, including spouses and dependents, from all contributors to 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.

**9. Risk Management:**

Self Insurance - The State of Colorado 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 and worker's compensation. The state Risk Management Fund is a restricted General Fund used for claims adjustment, investigation, defense and authorization for the settlement and payment of claims or judgements against the State except for employee medical claims. Property claims are not self-insured; rather the State has purchased insurance.

Colorado employers are liable for occupational injuries and diseases of their employees. Benefits are prescribed by the Worker's Compensation Act of Colorado for medical expenses and loss of wages resulting from job-related disabilities. The State utilizes the services of Pinnacol Assurance (formerly Colorado Compensation Insurance Authority), a related party, to administer its plan. The State reimburses Pinnacol Assurance for the current cost of claims paid and related administrative expenses.



**COLORADO STUDENT OBLIGATION BOND AUTHORITY  
PREPAID TUITION FUND  
NOTES TO FINANCIAL STATEMENT (CONTINUED)  
JUNE 30, 2002 AND 2001**

**9. Risk Management (continued):**

The Authority participates in the Risk Management Fund. State 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 for 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 necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

The limits of liability for which the State accepts responsibility pursuant to the Colorado Governmental Immunity Act, section 24-10-101 are as follows:

<u>Liability</u>	<u>Limits of Liability</u>
General & Automobile	Each person \$150,000 Each occurrence \$600,000

There were no significant reductions or changes in insurance coverage from the prior year. Settled claims did not exceed insurance coverage in any of the past three fiscal years.

Furniture and Equipment – The State of Colorado carries a \$15,000 deductible replacement policy on all state owned furniture and equipment. For each loss incurred, the Authority is responsible for the first \$1,000 of the deductible and the State of Colorado is responsible for the next \$14,000 of the deductible. Any loss in excess of \$15,000 is covered by the insurance carrier up to replacement cost.

**10. Net Assets:**

Restricted net assets includes net assets that are restricted for use either externally imposed by creditors, grantors, contributors, or laws and regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

The Prepaid Tuition Fund had restricted net assets of \$629,000 and \$1.0 million as of June 30, 2002 and 2001, respectively. Net assets are restricted for the purpose of meeting future payments for higher education expenses as stipulated by the Colorado Revised Statutes 23-3.1-206.7(5)(a) and as agreed to in the advance payment contracts.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY**  
**PREPAID TUITION FUND**  
**NOTES TO FINANCIAL STATEMENT (CONTINUED)**  
**JUNE 30, 2002 AND 2001**

**11. Economic Dependency on Market Fluctuations:**

The Prepaid Tuition Fund incurred substantial decreases in net assets during the two years ended June 30, 2002 and 2001, primarily due to investment losses. The Administrative Fund within the Student Loan Program Funds transferred \$3.75 million to the Prepaid Tuition Fund during the year ended June 30, 2002 to mitigate the losses incurred and to provide the Fund with sufficient assets to remain actuarially sound. The Administrative Fund has no obligation to provide additional transfers in the future. The Prepaid Tuition Fund is dependent on increases in net assets through growth, investment income and/or future contributions to meet its obligations.

**12. Subsequent Event:**

For the three months ended September 30, 2002, the Prepaid Tuition Fund incurred investment losses of approximately \$3.5 million.

**Independent Auditor's Report on Compliance and on Internal Control  
Over Financial Reporting Based on Audit of Financial Statements  
Performed in Accordance with Government Auditing Standards**

Members of the Legislative Audit Committee:

We have audited the financial statements of Colorado Student Obligation Bond Authority, Prepaid Tuition Fund, Department of Higher Education, State of Colorado as of and for the year ended June 30, 2002, and have issued our report thereon dated November 4, 2002. 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 Colorado Student Obligation Bond Authority, Prepaid Tuition Fund'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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Colorado Student Obligation Bond Authority, Prepaid Tuition Fund'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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 Henderson LLP*

Greenwood Village, Colorado  
November 4, 2002

**The electronic version of this report is available on the Web site of the  
Office of the State Auditor  
[www.state.co.us/auditor](http://www.state.co.us/auditor)**

**A bound report may be obtained by calling the  
Office of the State Auditor  
303-869-2800**

**Please refer to the Report Control Number below when requesting this report.**

**Report Control Number 1464A**

## LIMITATIONS ON DISCLOSURE OF INFORMATION CONTAINED IN THIS DOCUMENT

The enclosed report is being distributed to you at this time for your information in accordance with Colorado Revised Statutes (CRS).

SECTION 2-3-103 (2) states in part:

All reports shall be open to public inspection except for that portion of any report containing recommendations, comments, and any narrative statements which is **released only upon the approval of a majority vote of the committee (emphasis supplied).**

SECTION 2-3-103.7 (1) states in part:

Any state employee **or other individual acting in an oversight role as a member of a committee, board, or commission** who willfully and knowingly discloses the contents of any report prepared by, or at the direction of, the Office of the State Auditor prior to **the release of such report by a majority vote** of the committee as provided in Section 2-3-103 (2) is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not more than five hundred dollars (emphasis supplied).