REPORT OF THE STATE AUDITOR

HIGHER EDUCATION COST CONTAINMENT

PERFORMANCE AUDIT
NOVEMBER 1995

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November 17, 1995

Members of the Legislative Audit Committee:

This report contains the results of our performance audit reviewing cost containment efforts at several institutions of higher education. This audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor's Office to conduct audits of all departments, institutions, and agencies of state government. It was conducted according to generally accepted government auditing standards.

This report presents our findings, conclusions, and recommendations, and the responses of the Auraria Higher Education Center, the Colorado State University System and Colorado State University, the Trustees of the State Colleges in Colorado, and the University of Colorado System and the University of Colorado at Boulder.

J. David Barba

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OFFICE OF STATE AUDITOR
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HIGHER EDUCATION COST CONTAINMENT PERFORMANCE AUDIT NOVEMBER 1995

Authority, Purpose, and Scope

This performance audit was conducted under authority of Section 2-3-103, C.R.S., which authorizes the State Auditor's Office to conduct audits of all departments, institutions, and agencies of state government. This report discusses our review of the following areas:

- Overview of Cost Containment in Higher Education
- Debt Refinancing
- Improvements to Student Loan Processes

We conducted this audit according to generally accepted government auditing standards. We gathered information through interviews, document reviews, and data analyses. Audit work was performed between June and September 1995.

We acknowledge the efforts and assistance extended by governing board and institution staff, including staff at the Auraria Higher Education Center (AHEC), the Colorado School of Mines (Mines), Colorado State University and the Colorado State University System (CSU), Pikes Peak Community College (Pikes Peak), the Trustees of the State Colleges in Colorado (Trustees), the University of Colorado System (CU) and the University of Colorado at Boulder (UCB), and Western State College (Western).

Overview of Cost Containment in Higher Education

The cost of education at institutions of higher education nationwide has increased faster than inflation in the last 15 years. In Colorado, general fund and resident tuition revenues per Full-Time Equivalent (FTE) student have increased by about 6 and 32 percent, respectively, between Fiscal Years 1990 and 1994. Additionally, the average cost for a resident student attending college has increased by 28 percent during the past five years. Each year, the Colorado Commission on Higher Education (CCHE) estimates the cost to students for attending college. Using these estimates, we identified the percentage of total costs resident students incur in each of the following categories: tuition--20 percent; room and board--41 percent; personal expenses--23 percent; fees--4 percent; books--5 percent; and health insurance--7 percent.

Rising costs have caused institutions to increase cost containment efforts. Institutions work to contain costs so that they can operate within the funds they have available. Additionally, containing costs in one area provides savings that can be used in another area. Containing costs also assists with attracting and retaining students since cost containment efforts may delay tuition or fee increases.

Our audit reviewed information on some of the cost containment efforts going on at institutions of higher education around the State. Our intent was to provide information that other schools might find useful in their efforts to contain costs. This report includes our review of cost containment efforts in the areas of debt refinancing and student loan processing.

Debt Refinancing

Governing boards typically refinance debt to save money, restructure payment schedules, or eliminate bond covenants that are burdensome. According to statutes, only governing boards are authorized to issue and refinance debt. To refinance for savings, the governing board issues new debt at a lower interest rate to pay off existing debt at a higher interest rate.

Our audit concluded that, in general, governing boards and institutions are saving money through their refinancing activities. We reviewed a recent refinancing at the Auraria Higher Education Center (AHEC), the Colorado State University System (CSU), the Trustees of the State Colleges in Colorado (Trustees), and the University of Colorado System (CU). All of the refinancings achieved some amount of savings, and three of the four refinancings had present value savings of over 3 percent of the refinanced principal--a generally accepted savings benchmark established in the professional literature.

Although we did not identify any significant problems with any of the refinancings we reviewed, refinancings involve a number of risks to governing boards and institutions. First, revenue bonds issued after 1986 can only be refinanced one time before the call date. (The call date is the first date when the bond can be paid off in full--usually ten years after the date of issue.) Therefore, it is important that the refinancing be structured so that the governing board receives maximum benefits from its single refinancing opportunity. Second, refinancings involve anticipating market conditions that can be volatile or unpredictable. Timing and efficiency are critical to achieving the lowest possible interest rate. Third, refinancings are complicated and require staff with specialized knowledge to evaluate their advantages and disadvantages. Governing boards may not have staff with this knowledge or experience. Finally, refinancings involve the participation of external parties, such as financial advisors, underwriters, and bond counsel. There is a financial incentive for some of these external parties to promote refinancings since they may get paid only when a refinancing is completed.

We suggest governing boards develop overall debt management strategies and policies to address these risks and to ensure each refinancing provides maximum benefit to the governing board and institution. Information from the Government Finance Officers Association confirms the value of debt management strategies and refinancing policies. These policies provide a framework for evaluating a refinancing to ensure it promotes the goals of the board and institution. Additionally, they provide mechanisms for clearly communicating debt management and refinancing goals to external parties.

During our review we found that CU and CSU had established their overall debt management strategies and policies in writing, and AHEC and the Trustees had not. Staff provided a number of reasons why they do not have these policies. First, they are concerned that policies will become outdated and prevent them from adjusting to market developments and changes. Second, they indicate policies may prevent them from completing a refinancing quickly since they will need to spend time on analysis at various points in the refinancing process to comply with policies.

We think boards can develop written debt management strategies and policies that address critical refinancing risks without limiting their flexibility. They can do this by developing policies that are not overly prescriptive. Policies should provide guidance but be broad enough to accommodate changing and dynamic market practices.

We recommend the Board of Directors of the Auraria Higher Education Center and the Trustees of the State Colleges in Colorado develop written debt management strategies and policies that establish a framework for evaluating refinancing opportunities. These policies should be in agreement with the overall financial goals of the boards and institutions, subject to review and approval by governing boards, and should require analysis when refinancings deviate from policies.

Auraria Higher Education Center Response:

Agree, subject to the understanding that policies should be somewhat broad in order to allow appropriate actions under different issues and varying circumstances.

Trustees of the State Colleges in Colorado Response:

Agree. The Office of State Colleges will prepare presentations on the principles of debt management for discussion by the Finance Committee of the Board of Trustees for the State Colleges in Colorado no later than the March 1996 meeting. These discussions will lead to the formulation of policies which will establish a framework for evaluating financing and refinancing proposals and opportunities within and among the State Colleges in Colorado. These policies and any ensuing revisions will be subject to the review and approval by the Finance Committee and, subsequently, by the Board of Trustees. It is anticipated that approved policies will be in place at the beginning of the 1997 fiscal year.

Our review identified some specific areas governing boards should address in their debt management strategies and policies to reduce the risks associated with refinancings. These areas include:

- **Roles and responsibilities of parties involved in refinancing decisions.** Refinancing responsibilities need to be clear among governing board and institution staff so that schools do not duplicate tasks or omit critical analyses. This is important because some boards do not refinance debt very often and may have staff turnover between refinancing opportunities. First, boards need to determine whether policies are needed at the governing board level only or whether additional policies are needed for institutions. If the institutions under the governing board are diverse, it may be appropriate to have policies at both board and institution levels. Second, boards need to decide who will be responsible for implementing policies. Boards included in our review delegated refinancing responsibilities differently. Whatever the method used, policies should establish the responsibilities of each group, clarify the lines of communication, and document the approvals needed at each decision point.

- **Appropriate refinancing goals.** Governing boards refinance debt for a number of appropriate reasons, including to save money, improve cash flow, or eliminate burdensome requirements in bond covenants. Although these reasons are all acceptable, some will be more in line with the governing board's debt management strategy than others. Therefore, debt management policies should identify and prioritize acceptable goals for refinancings. This provides a mechanism for communicating acceptable reasons for pursuing a refinancing to external advisors. Additionally, it provides criteria for evaluating refinancings that deviate from established policies to make sure the refinancing is appropriate.

- **Preferred approach for realizing savings.** Savings from refinancings can be taken at the beginning of the debt, over the life of the debt, or at the end of the debt. Each of these methods has different benefits, depending on how the savings will be used. Policies addressing how savings will be realized reduce the risk that the approach and use will be inconsistent with the governing board's overall debt management strategies.

- **Acceptable thresholds for savings.** Since savings are the primary goal of most refinancings, boards should establish guidelines addressing threshold savings. There should be one threshold for initiating a refinancing. This is used to evaluate a refinancing opportunity to determine whether it is cost-beneficial to pursue it. There should also be a threshold for completing a refinancing. This is used to determine if adequate savings will be achieved if the issue goes to market, and the threshold will be specific to each refinancing, depending on its purpose and goals.

- **Appropriate methods for calculating and evaluating savings.** Present value calculations present the savings from a refinancing in today's dollars. The professional literature indicates that present value savings is the best method for evaluating savings since it provides a level playing field for comparing savings from one refinancing opportunity with another. Debt service savings compares total dollars paid under the old repayment schedule with total dollars to be paid under the new schedule. This method is useful for determining how refinancing will affect cash flow. Both methods should be calculated net of issuance costs and used to evaluate savings throughout the refinancing process. Policies establishing how savings should be calculated will make sure that methods are applied consistently and that boards are not comparing savings which have been calculated with different or inappropriate methods

- **Risks associated with advice from external advisors.** Governing boards typically obtain assistance from professional external parties who have expertise with refinancings. These parties include financial advisors, underwriters, and bond counsel. First, governing boards need to select the arrangement for using these parties that is best for meeting their needs since each arrangement has different advantages and disadvantages. Second, governing boards need to determine the method of compensation that balances their need for cost-effective and independent advice. Third, boards need to develop efficient procedures for obtaining external parties so that procedures do not impair the board's ability to get to market quickly if a refinancing occurs during a period of fluctuating interest rates.

- **Consistent analysis of recurring bond issue options.** Bond issues commonly include a number of options that must be addressed for each refinancing. Examples include requirements for insurance, reserves, and surety bonds. These requirements need to be analyzed consistently so that boards can select the most cost-effective method for addressing them.

We recommend the Auraria Higher Education Center, the Colorado State University System, the Trustees of the State Colleges in Colorado, and the University of Colorado System ensure their debt management strategies and policies address the critical risks related to refinancing as described above.

Auraria Higher Education Center Response:

Agree. The Auraria Higher Education Center believes that it practices most of the recommended techniques on an informal basis now, but acknowledges the desirability of formalizing these.

Colorado State University System Response:

Partially agree. CSU believes it has, currently in place, strong strategies and procedures to address each of these issues. However, the State Board of Agriculture will review its debt management strategies and policies to verify that they are appropriate.

Trustees of the State Colleges in Colorado Response:

Agree. The Office of State Colleges will ensure that these risks, at a minimum, will be addressed during the discussions by the Board of Trustees.

University of Colorado System Response:

Agree. The Treasurer's Office will review how existing policy addresses these issues and determine beneficial modification by July 1, 1996.

Improving Student Loan Processes

The federal government created the student loan program (currently titled the Family Federal Education Loan Program or FFEL) in 1965 to make it easier for low- and middle-income students to attend college. A number of schools across the nation have reported problems administering FFEL effectively. As a result, the federal government, the State, and institutions of higher education have sought ways to improve the program. Solutions have taken two forms:

- **Direct Lending.** This is a new program where the federal government, rather than banks, is the lender. Financial aid offices at colleges and universities originate loans and issue promissory notes, and the federal government is responsible for collection.

- **Automating and streamlining FFEL processes.** These include two separate programs--Electronic Data Express (EDE), developed by the federal government to automate transmission of the financial aid application, and E2 Disbursement Clearing House, developed by the Colorado Student Loan Program, to provide electronic funds transfer from lenders to institutions.

Although there are differing opinions at national and state levels about whether the federal government should be taking on the role of lender in the Direct Lending program, our audit did not consider this issue. Our review was limited to how state schools use these programs to improve their financial aid processes and provide better services to students.

Our audit reviewed Direct Lending programs at the University of Colorado at Boulder (UCB) and Colorado State University (CSU). We concluded Direct Lending provided a number of benefits to students and schools at minimal cost. For example:

- **Revenues and savings at both schools exceeded implementation and operation costs.** At UCB, revenues and savings during Fiscal Year 1995 exceeded implementation and operating costs by over $190,000. At CSU, revenues and savings exceeded implementation and operating costs by over $133,000 for the same time period.

- **Direct Lending has created interest revenue for the State Treasury.** Direct Lending provides a large influx of funds (about $22 million at each school) several days before school starts. Schools report this figure is growing each year. More than half of these funds are retained by institutions to pay tuition, fees, and housing; the balance is refunded to students. This means that schools are receiving these payments earlier than they did in the past, so they do not need to draw their state-appropriated funds until later in the semester. This is a benefit to the Colorado taxpayer since the State Treasury earns interest on the state-appropriated funds until schools need them.

- **Direct Lending improves services to students.** Direct Lending usually provides loan proceeds within 72 hours after submitting applications; previously this could take from four to six weeks. Additionally, since schools receive loan proceeds electronically, students no longer wait in long lines at the beginning of each semester to receive their loan checks.

- **Direct Lending has improved the efficiency of other business processes.** Direct Lending has improved cash flow at both UCB and CSU and reduced workloads in the Bursar's Offices.

We also identified some areas where schools could improve their systems for:

- **Evaluating financial aid programs.** Neither UCB nor CSU has much quantifiable information evaluating their financial aid programs, including Direct Lending. This information would be useful for identifying program strengths, weaknesses, and shifts in workload, and for making program improvements. Additionally, this information would be useful to other schools in the State who are considering improvements to their financial aid processes.

- **Tracking and estimating costs.** CSU did not have good information to identify new costs attributable to Direct Lending. For example, during Fiscal Year 1995 the financial aid office reported to the Executive Budget Committee that it spent about $65,000 in additional costs for Direct Lending when it actually spent about $32,000. Accurate cost information is important so that the Executive Budget Committee can make good funding decisions regarding competing and worthwhile programs.

- **Monitoring federal draw requirements and interest benefits.** CSU did not draw federal funds for Direct Lending as early as it could have during spring semester 1995. If it had, we estimate it would have earned an additional $27,000 in interest revenue. Careful monitoring of federal regulations concerning draws will ensure CSU can take advantage of opportunities to earn interest and to fully report and evaluate the benefits of Direct Lending.

- **Tracking student comments and complaints.** The financial aid office at CSU tracks student comments on each student's computerized loan file, but cannot retrieve them easily. As a result, the financial aid office cannot easily evaluate student comments to identify strengths and weaknesses of Direct Lending or other financial aid services. There are inexpensive processes that can track student comments manually. CSU should develop a manual process of tracking student complaints to collect and evaluate student satisfaction and should use the information to make decisions about program modifications and improvements.

We recommend Colorado State University and the University of Colorado at Boulder improve processes for measuring and evaluating the results of Direct Lending and other financial aid programs.

Colorado State University Response:

Agree. The University agrees that appropriate outcome measurements would provide a valuable tool for evaluating the efforts of the Financial Aid Office.

University of Colorado at Boulder Response:

Agree. The financial aid office at the University of Colorado, Boulder will identify appropriate data to be collected to assist the office in new program management, in evaluating the results of Direct Lending, and for general resource management within the Department. Efforts to identify and collect data have already begun and will continue. Additionally, we will review our main processing work flows to determine other necessary information that will assist in the management of our resources.

Over the next six months, the specific processes and information will be identified that are appropriate for assisting the office in good resource management decisions. Once identified, a plan will be developed to identify the measurements, outcomes, and systems necessary for obtaining the data.

We recommend Colorado State University improve internal systems for tracking and reporting cost information, monitoring federal regulations concerning draw dates, and recording student complaints and comments.

Colorado State University Response:

Partially agree. The University agrees that the analysis provided to the auditor did not adequately account for the incremental costs/benefits of the Direct Lending program. We do not agree that a retroactive cost analysis for the Direct Lending program would be an effective use of resources at this point in time. Direct Lending, as was stated in the audit report has greatly improved the efficiency of getting loan proceeds in the hands of students at the beginning of a semester, which has considerable cost saving benefits to the students and their families. The main impetus for its implementation was to improve service to our students. The University participates in Direct Lending and other financial aid programs because approximately 65 percent of our students could not afford the cost of higher education without this support. Even if it had resulted in increased cost, the University may still have participated in the Direct Lending program because of improved service to students. The Executive Budget Committee will carefully evaluate the information provided in this audit, and take action as appropriate.

The University does monitor federal regulations for all programs affected by such regulations. The University was completely familiar with the regulations concerning the Direct Lending program. While there was some initial disbelief that the federal government would provide cash 21 days in advance, this was fully understood prior to drawing funds under the letter of credit. The failure was not due to the lack of familiarity with regulations or the absence of procedures to fully take advantage of potential interest earnings. CSU failed on one occasion to draw timely because of the absence of a key individual during the time it should have been processed and the failure to have adequate back-up to process the federal draw. The University will take steps to help assure this will not occur again. The University does track interest revenue and can identify specific earnings due to the early influx of federal funds. In fact, we provided the data that is referenced in the audit report. Regarding student complaints, please see previous summary response addressing outcome measurements.

We also reviewed Electronic Data Express (EDE) at Colorado School of Mines (Mines) and Pikes Peak Community College (Pikes Peak). EDE streamlines transmission of the financial aid application to the United States Department of Education (Department). We found EDE also provides benefits to schools. EDE allows schools to transmit corrections to student financial aid applications to the Department electronically instead of manually. The Department informs schools of the student's eligibility within 48 to 72 hours of transmission. Before EDE this could take up to six weeks. Additionally, implementation costs at both schools were minimal--about $4,300 at Pikes Peak and $180 at Mines.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	23	Develop written debt management strategies and policies that establish a framework for evaluating refinancing opportunities.	Auraria Higher Education Center	Agree	March 31, 1996
			Trustees of the State Colleges in Colorado	Agree	July 1, 1996
2	36	Ensure debt management strategies and policies address the critical risks related to refinancing.	Auraria Higher Education Center	Agree	September 30, 1996
			Colorado State University System	Partially Agree	Fiscal Year 1996
			Trustees of the State Colleges in Colorado	Agree	July 1, 1996
			University of Colorado System	Agree	July 1, 1996

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
3	49	Improve processes for measuring and evaluating the results of Direct Lending and other financial aid programs.	Colorado State University	Agree	In process
			University of Colorado at Boulder	Agree	December 1, 1996
4	52	Improve internal systems for tracking and reporting cost information.	Colorado State University	Partially Agree	--
5	53	Improve cash management practices by monitoring federal regulations concerning draw dates and by tracking interest earnings.	Colorado State University	Agree	Fiscal Year 1996
6	55	Improve systems for recording student complaints and comments, and periodically review the information to make modifications and improvements.	Colorado State University	Agree	In process

Overview of Cost Containment

Introduction

The cost of education at institutions of higher education nationwide has increased faster than inflation over the last 15 years. In Colorado, general fund and resident tuition revenues at public institutions have increased by about 11 and 38 percent, respectively, between Fiscal Years 1990 and 1994. Additionally, general fund and resident tuition revenues per Full-Time Equivalent (FTE) student have increased by about 6 and 32 percent, respectively, for the same time period. The following charts show these data for the past five years:

Total General Fund and Tuition Revenues for All Public Institutions of Higher Education
Fiscal Years 1990 - 1994

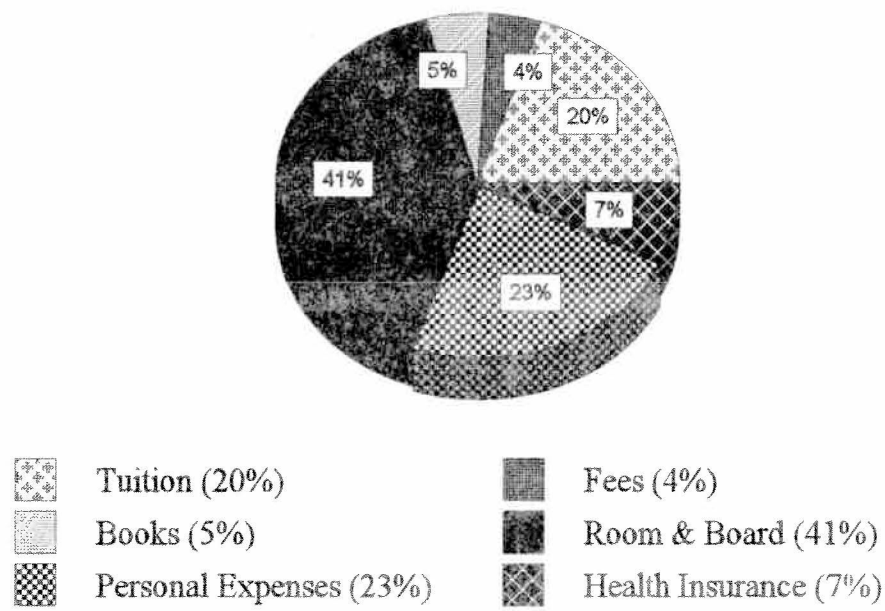
	FY90	FY91	FY92	FY93	FY94	Percent Change
Total General Fund Revenues Per Year (in millions)	$ 382.6	$ 397.7	$ 399.8	$ 414.7	$ 425.2	11.1
Total Resident Tuition Revenues Per Year (in millions)	164.7	182.2	205.8	223.4	228.0	38.4
General Fund Revenue Per Resident FTE Student (actual dollars)	3,417	3,478	3,415	3,504	3,615	5.8
Tuition Revenue Per Resident FTE Student (actual dollars)	1,471	1,593	1,758	1,888	1,939	31.8

Source: CCHE Scorecard Data Tables, March 1995.
Note: Dollars are not adjusted to reflect inflation.

Each year, the Colorado Commission on Higher Education (CCHE) estimates the overall cost to students for attending college. These expenses fall into six categories: tuition, fees, room and board, books, health insurance, and personal expenses. Tuition payments support the cost of instruction. Most payments for fees, room and board, and books support the cost of auxiliaries. (Auxiliaries are self-funded activities such as housing, parking, dining, and recreation, which are ancillary to institutions' primary missions of education, research, and public service.) The following chart shows the percentage of total costs incurred by resident students in each of these expenditure categories during Fiscal Year 1995.

Cost of Education For Resident Students

Percent Spent on Each Item During Fiscal Year 1995



Source: State Auditor's Office analysis of information provided by the Colorado Commission on Higher Education.

There have also been increases in the cost of education for resident students in each of these expenditure categories. During the past five years the average cost for a resident student attending college has increased by 28 percent as shown in the following chart.

Average Cost for Attending College Resident Undergraduate Living on Campus				
	Fiscal Year 1991	Fiscal Year 1995	Difference	Percent Increase[1]
Tuition	$1,593	$1,939	$ 346	22
Fees	316	373	57	18
Books	425	485	60	14
Room and Board	3,110	3,932	822	26
Personal Expenses	1,620	2,183	563	35
Health Insurance	408	666	258	63
Total	**$7,472**	**$9,578**	**$2,106**	**28**

Source: State Auditor's Office analysis of information provided by the Colorado Commission on Higher Education.
[1]**Note:** The Denver-Boulder Consumer Price Increase for 1990-91 to 1994-95 was 17 percent.

Why Institutions of Higher Education Work To Contain Costs

National concerns about the cost of higher education have caused institutions to increase cost containment efforts. According to the professional literature, there are three principal reasons why higher education systems and institutions are working to control their costs:

- **Limited funds are available for operations.** Institutions of higher education, like all of state government, must operate within the funds they have available. The General Assembly controls the general funds available to institutions through the annual appropriation process to governing boards. Additionally, it controls some of the income available through tuition by setting limits on tuition increases. Therefore, institutions must control their costs so that they can operate within funds available.

- **Containing costs in one area provides savings that can be used for new projects or activities in other areas.** Since limited funds are available, institutions that can save money in one area will be able to use the savings for other purposes. This is one way institutions can fund new or high-priority projects within their current funding base.

- **Containing costs assists with attracting and retaining students.** Controlling costs may delay tuition or fee increases. This makes the students' cost of education at a particular institution more affordable, which in turn helps the institution attract and retain students.

Two of the largest systems of higher education in Colorado (the University of Colorado or CU and Colorado State University or CSU) report their cost containment projects to their respective governing boards each year. Additionally, both of these systems address cost containment in their strategic and long-range planning documents.

Policies Established by the General Assembly and the Commission on Higher Education Encourage Cost Containment

Both the General Assembly and the Colorado Commission on Higher Education (CCHE) have policies for appropriating and allocating funds that encourage institutions of higher education to contain costs:

- **State appropriation distribution formulas.** Appropriations for higher education differ significantly from other state agencies in that each governing board receives a lump sum appropriation and must manage all cost increases and new programs within the appropriation. It is the responsibility of CCHE to develop formulas to allocate funds among the governing boards. For the past several years the formula for base funding has been the prior year's general fund allocation base (for each governing board) plus a percentage increase to cover cost increases such as salaries, utilities, and other operating expenses. In other words, each governing board receives a general fund allocation that represents what it was authorized to spend in the prior year plus any percentage increase recommended by CCHE and authorized by the General Assembly. Institutions must work within funds received (or find other funding sources) to pay for new programs or priorities.

- **General Fund appropriations.** The past few years, the General Assembly has provided percentage increases to the general fund appropriation for higher education based on what it believes the State can afford to spend. CCHE has asked the General Assembly to provide a percentage increase equal to inflation (using the Denver-Boulder consumer price index as a measure), but the General Assembly has not always been able to provide that increase. Data provided by CCHE comparing general fund increases with inflation show that between Fiscal Years 1990 and 1994, total general fund appropriations and general fund appropriations for resident Full-Time Equivalent (FTE) students have decreased by 5 and 9.6 percent, respectively, after adjusting for inflation. This means that after considering the effect of inflation, general fund dollars have less buying power. Therefore, institutions must either contain costs or find alternate funding sources to operate within funds available and mitigate the impact of inflation.

- **Tuition appropriations.** The TABOR amendment to the State Constitution (Article X, Section 20) limits the revenue the State can take in each year, including tuition revenue. To make sure the State does not exceed revenue limits under TABOR, the General Assembly sets caps for tuition increases. Therefore, governing boards cannot increase tuition beyond certain limits to pay for new projects or priorities. Funds needed beyond general fund appropriations and tuition revenues must be obtained either from cost containment efforts or other funding sources.

- **House Bill 95-1196 policy areas.** House Bill 95-1196 provides additional general fund appropriations to governing boards based on five policy areas. For Fiscal Year 1996 these policy areas include:

  --link to secondary education (kindergarten through 12th grade),
  --technology
  --productivity
  --workforce training
  --enrollment

  The General Assembly appropriated $5.25 million for these policy areas for Fiscal Year 1996, or about 1 percent of the total general fund appropriation for all general campuses. The General Assembly encourages efforts in these policy areas by providing new funding (over and above the general fund base plus percentage increase) only to programs in these policy areas.

Criteria and Scope of Review

Our audit reviewed the professional and national literature on cost containment and, on the basis of our analysis, determined that cost containment efforts generally have the following attributes:

- **They are ongoing.** Cost containment activities are ongoing, long-term efforts that facilitate efficient budget management. They are not one-time responses to budget crises or antidotes to poor management practices.

- **They result in stable or improved outcomes at a lower expenditure.** Cost containment efforts change or streamline an activity while maintaining or improving outcomes. Additionally, cost containment efforts provide these benefits at a lower expenditure level (or at a level lower than would have occurred without the cost containment effort).

- **They have costs and benefits that are anticipated, planned for, and evaluated.** Expected savings and outcomes should be anticipated in advance of implementing any cost containment project so that the project can be planned accordingly. Additionally, projects should be evaluated after implementation to determine if savings and other outcomes occurred as planned. Evaluation also assists with identifying areas for further improvement.

- **They quantify savings for appropriate time periods.** Cost containment efforts quantify savings benefits for reasonable terms (usually three to five years) so that savings are a direct result of the cost containment effort. If savings are quantified for time periods that are too long, other variables in addition to the cost containment effort may be contributing to the savings.

We wanted to provide information on some of the cost containment efforts going on at institutions of higher education around the State. Our intent was to provide information that other state schools might find useful in their efforts to contain costs. To select topic areas, we reviewed lists of cost containment projects provided by CU, CSU, and other institutions. We grouped the projects into 14 functional topic areas. We selected projects from two topic areas and evaluated them against our cost containment criteria. The areas we reviewed included:

- **Debt refinancing.** We concluded that, in general, debt refinancing activities conducted by governing boards were meeting our cost containment criteria and saving institutions money. We discuss our review of debt refinancing at the Auraria Higher Education Center, the Colorado State University System, the Trustees of the State Colleges in Colorado, and the University of Colorado System in Chapter 1.

- **Financial aid and student loan processes.** We concluded that projects to improve financial aid and student loan processing (including Direct Lending and Electronic Data Express) improved services to students and provided benefits to institutions at minimal cost. However, institutions could improve efforts to estimate costs, savings, and changes in outcomes and other benefits in advance of implementing projects. We discuss our review of student loan processes at Colorado State University, the University of Colorado at Boulder, Colorado School of Mines, and Pikes Peak Community College in Chapter 2.

Debt Refinancing

Chapter 1

Introduction

Governing boards and institutions typically refinance debt to save money. In a refinancing, the governing board issues new debt at a lower interest rate to pay off existing debt at a higher interest rate. Refinancing debt can be beneficial for an institution in much the same way refinancing a home mortgage can be beneficial for an individual. When interest rates decline below the interest rate of the existing debt, institutions can save money by refinancing the debt and making lower payments.

Governing boards and institutions may also refinance debt for reasons other than savings. These include restructuring the payment schedule to improve cash flow or eliminating burdensome requirements contained in bond covenants. Although saving money is the most common reason for refinancing, the professional literature indicates these other reasons are appropriate and can be beneficial as well.

Governing Boards Have Authority To Issue Debt

The State Constitution does not permit any state entity to pledge state funds for repaying debt.

According to statutes, only governing boards, not institutions, have authority to issue and refinance debt. The State Constitution does not permit any state entity, including governing boards, to pledge state funds for repaying debt. Therefore, if governing boards are going to pledge revenues to pay for a debt, they can only issue debt for activities that are not supported by state-appropriated funds. At institutions of higher education, activities that commonly meet these requirements are self-funded or "auxiliary" activities. Auxiliary activities are activities ancillary to each institution's primary mission of instruction, research, or public service. Examples of common auxiliaries are housing, parking, dining, recreation, or health facilities.

Governing boards often use revenue bonds to finance the construction of auxiliary facilities. The auxiliary pays off the bonds with revenues it receives once it is fully constructed and operating. The revenues come from fees received from students and other people who use the facilities.

Governing boards may also issue debt through certificates of participation, or COPs. Since COPs are based on lease payments and do not obligate governing boards to repay the debt by pledging revenues, they can be used to finance capital construction activities that are supported by state-appropriated funds.

Refinancings Do Not Result in Direct Savings of Tuition and Tax Dollars

Since refinancings generally involve auxiliary activities and these activities are not supported by either general fund or tuition revenues, the savings will not reduce the amount of money institutions need for education. Therefore, refinancings do not impact operations supported by tuition or state tax dollars. Although debt refinancings could result in lower fees for students who use certain auxiliary services, we found institutions were generally using savings to finance additional services or projects rather than to reduce fees. However, one institution did use its savings to prevent a fee increase.

Refinancings Result in Savings for Institutions

Governing boards and institutions are saving money through refinancing activities.

We reviewed a recent refinancing at each of the following four governing boards or institutions: the Auraria Higher Education Center (AHEC), the Colorado State University System (CSU), the Trustees of the State Colleges in Colorado (Trustees), and the University of Colorado System (CU). (The Trustees' bond issue was for new money at Adams State College and Mesa State College and included a refinancing at Western State College (Western). When we mention Trustees or Western in this chapter, we are referring to our review of Western's refinancing.) We concluded that, in general, governing boards and institutions are saving money through their refinancing activities. Three of the four refinancings we reviewed had present value savings of over 3 percent of the refinanced principal--a generally accepted savings benchmark according to the professional literature. The following chart shows the savings each board or institution achieved from the refinancings we reviewed:

Savings Earned From Refinancings			
Institution or Governing Board	**Amount Refinanced**	**Present Value Dollar Savings[1]**	**Savings as a Percentage of Refinanced Principal**
Auraria Higher Education Center	$ 17,980,000	$ 1,506,299	8.38
Colorado State University System	6,725,000	294,685	4.36
The Trustees and Western State College[2]	12,975,000	65,169	0.50
University of Colorado System	12,662,266	637,360	5.03

Source: State Auditor's Office analysis of each bond prospectus and other information provided by institutions and governing boards.

Notes: [1]Present value savings are presented net of all issuance costs. Although savings may be realized over many years, the professional literature indicates present value savings is the best measure of savings since future dollars are not worth as much as today's dollars.
[2]Western reports its goal was to alter bond covenants to release money in its debt service reserve fund. However, it also achieved savings.

Our review concluded that the institution or governing board achieved some amount of savings in each refinancing we reviewed. Additionally, there were no substantial problems identified at any school that indicated to us the refinancing was not appropriate.

Refinancings Involve Risks to Boards and Institutions

Although we did not identify significant problems with the refinancings we reviewed, refinancings involve a number of risks to governing boards and institutions:

- **Governing boards can only refinance each bond issue once before the call date.** According to federal law, tax-exempt revenue bonds issued after 1986 can only be refinanced one time in advance of the call date. (The call date is the first date when the bond can be paid off in full--usually ten years after the date of issue.) Therefore, it is essential for the refinancing to achieve the institution's refinancing goals (including savings and other goals set forth in the governing board's debt management strategy) so that the governing board receives maximum benefits from its single refinancing opportunity.

- **Market conditions can be volatile or unpredictable.** Refinancings involve anticipating market conditions so that refinancings achieve the lowest possible interest rate. Timing and efficiency are critical to completing a refinancing when market conditions are favorable.

- **Refinancings require specialized expertise.** Refinancings are complicated and require staff with specialized training, knowledge, or experience to evaluate their advantages and disadvantages. Governing boards may not have staff with this knowledge or experience.

- **Refinancings involve the participation of external parties.** External parties such as financial advisors, underwriters, and bond counsel have significant roles in refinancings. Depending on the financial arrangements, these parties often get paid only when a refinancing is completed. Therefore, there is a financial incentive for some external advisors to promote refinancings.

It is important for governing boards and institutions to have controls that mitigate the risks associated with refinancings. We discuss ways boards and institutions can do this in the remainder of this chapter.

Develop Overall Debt Management Strategies and Refinancing Policies

Debt management strategies and policies provide a framework for evaluating refinancing opportunities.

Many decisions are involved with pursuing and completing a refinancing. Most decisions involve a number of possible approaches, none of which are necessarily right or wrong. Therefore, governing boards are faced with evaluating these approaches at various points in the refinancing process and selecting the best one under the circumstances. That is where debt management strategies and refinancing policies add value--they provide a framework for evaluating a refinancing to ensure it promotes the debt management goals of the board and institution.

Debt management strategies will address all aspects of debt management and establish overall policies that are in line with the other financial goals of governing boards and institutions. Typically, they provide guidance on debt capacity, roles and responsibilities of parties, methods of obtaining external advisors, and preferred approaches to issuing and paying off debt. Refinancing policies provide additional guidance for pursuing and evaluating refinancing opportunities--they address specific decisions in the refinancing process to make sure each refinancing contributes to the overall debt management goals. Typically, refinancing policies address appropriate reasons for refinancings, preferred methods for realizing savings, and threshold savings goals. Both debt management strategies and refinancing policies provide a vehicle for clearly communicating refinancing goals to external advisors.

During our review we found that CU and CSU had written debt management strategies and policies (statutes require CU to have them), and AHEC and the Trustees did not. Additionally, only CU had written policies specifically addressing refinancing; CSU, AHEC, and the Trustees did not. Staff for some of the boards provided several reasons why they haven't developed debt management strategies and refinancing policies. First, they report that the capital market (where bond issues are sold) is dynamic and constantly changing. Policies may become outdated and prevent them from taking advantage of new market products or instruments. Second, they indicate that following policies may prevent them from completing a refinancing quickly, since time is required to make sure appropriate analysis has been done to comply with policies.

Our review of the professional literature confirms the value of debt management strategies and refinancing policies for mitigating the risks associated with managing debt. According to the Government Finance Officers Association, formal debt management strategies and refinancing policies:

- Offer a systematic, understandable approach to elected or hired officials.

- Promote consistency with other financial goals and objectives of the [governing board or institution].

- Provide justification for decisions on when to undertake a refinancing.

- Ensure that staff time is not consumed unnecessarily.

- Ensure that some minimum level of cost savings is achieved.

We think boards can develop written debt management strategies and policies that address critical risks without limiting their flexibility. They can do this by ensuring these policies are not overly prescriptive. Policies should provide guidance and be broad enough to accommodate changing and dynamic market practices. We provide specific suggestions for issues that governing boards and institutions should address in their debt management strategies and refinancing policies later in this chapter.

Recommendation No. 1:

The Auraria Higher Education Center and the Trustees of the State Colleges in Colorado should develop written debt management strategies and policies that establish a framework for evaluating refinancing opportunities. Specifically, these policies should:

a. Be in agreement with the overall financial goals of the boards and institutions.

b. Be subject to review and approval by governing boards.

c. Require evaluation and analysis when refinancings or aspects of refinancings deviate from policies.

Auraria Higher Education Center Response:

Agree, subject to the understanding that policies should be somewhat broad in order to allow appropriate actions under different issues and varying circumstances. This appears to be consistent with the auditor's statement that policies should not be overly prescriptive. The Auraria Higher Education Center views the probable content of such a policy as emphasizing roles and responsibilities and be process oriented. It is possible that in adopting a policy, the Board might wish to delegate, as, for example, to its committee responsible for financial matters, such matters as prioritization of refinancing goals and determination of refinancing thresholds. These may be expected to differ from issue to issue, and over time. Delegation of responsibility for defining these specifics may provide more flexibility in practice.

Trustees of the State Colleges Response:

Agree. The Office of State Colleges will prepare presentations on the principles of debt management for discussion by the Finance Committee of the Board of Trustees for the State Colleges in Colorado no later than the March 1996 meeting. These discussions will lead to the formulation of policies which will establish a framework for evaluating financing and refinancing proposals and opportunities within and among the State Colleges in Colorado. These policies and any ensuing revisions will be subject to the review and approval by the Finance Committee and, subsequently, by the Board of Trustees. It is anticipated that approved policies will be in place at the beginning of the 1997 fiscal year.

Define Roles and Responsibilities of Parties Involved in Refinancing Decisions

The concepts involved with refinancing debt are complicated. These complexities are magnified by the fact that many governing boards do not refinance debt very often. Therefore, turnover among governing board or institution staff may cause the board or institution to lose essential staff who have participated in past refinancings. For example, both Western and AHEC have had significant staff turnover since their last refinancings. If refinancing responsibilities are not clear among participants, schools may omit a critical analysis in one area or may be duplicating tasks. Consequently, it is important for governing boards to address the roles and responsibilities of parties involved in refinancings. This should be done in two areas:

- **Deciding whether institutions, in addition to governing boards, need refinancing policies.** Each governing board will need to decide whether it should establish one set of debt management and refinancing policies at the governing board level or whether additional policies are needed at the institution level. One advantage to a single set of policies is that it establishes consistent refinancing practices across all institutions. However, if the institutions under the governing board are diverse, it can be difficult for a single set of policies to address the different needs of all institutions. In this instance, additional policies addressing refinancings may be appropriate at the institution level as well. Either way, the governing board should review and approve all policies since it has statutory responsibility for decisions concerning issuing or managing debt.

- **Deciding who is responsible for implementing policies.** In practice, governing boards delegate many responsibilities related to refinancings to their staff and to the institutions. Each of the boards included in our review delegated refinancing responsibilities differently. CSU established a finance committee composed of staff from both the System and the institutions, and the finance committee presented information and made recommendations to the governing board. AHEC used a small finance committee that reported to a subcommittee of governing board members. The subcommittee screened information and presented recommendations to the board as a whole. Whatever method the governing boards decide to use, policies should establish the responsibilities of each group, clarify the lines of communication, and document any approvals needed at each decision point in the refinancing process.

Determine Appropriate Refinancing Goals

There are a number of acceptable refinancing goals. The professional literature we reviewed identified the following goals as acceptable:

- **Savings.** This is the primary reason for considering a refinancing. Governing boards can further define the savings objective by establishing a minimum savings amount, or threshold, which must be met before pursuing a refinancing opportunity. Savings was the primary goal for the refinancings we reviewed at CU, CSU, and AHEC.

- **Restructuring the stream of debt service payments.** Institutions and boards pay off revenue bond debt according to a schedule that establishes the time and amount of each payment. (This is called the debt service schedule.) The schedule is established at the time the debt is issued. Refinancing can be used to establish a new schedule for paying off the debt. One reason for doing this is to improve cash flow for the auxiliary activity.

- **Eliminating or changing burdensome bond covenants.** Bond covenants include a number of requirements to protect investors. Boards and institutions must adhere to these requirements during the term of the debt. As time passes, a specific bond covenant may become burdensome to institutions. A board or institution may be able to eliminate the covenant through a refinancing. For example, a covenant may require an institution to keep a certain percentage of funds in reserve in case it has difficulty making its debt payments as scheduled. Refinancing can eliminate this reserve requirement and make the funds available for other purposes. This was the goal of the refinancing we reviewed at Western.

Although all of these goals are acceptable, certain refinancing goals will be more in line with the governing board's overall debt management strategy than others. That is why we suggest governing boards identify the acceptable goals for refinancing and prioritize them in their refinancing policies. This provides the following benefits:

- **A mechanism for communicating acceptable reasons for pursuing a refinancing to external advisors.** External consultants, such as financial advisors, are often the parties that bring refinancing opportunities to the attention of governing boards and institutions. Policies establishing acceptable refinancing goals provide criteria to external consultants for evaluating refinancing opportunities.

- **Criteria for evaluating refinancings that deviate from established policies.** Individual refinancings may have goals that are different from those established in policies, and those goals may have merit. However, the governing board should evaluate the refinancing goal to make sure it is appropriate, even though it deviates from refinancing goals established in policies.

Identifying appropriate goals for refinancings in debt management policies is important since most tax-exempt debt can only be refinanced one time. This helps ensure boards and institutions make the best decision when evaluating refinancing opportunities.

Goals for Refinancings Should Be Clear

We identified some differences among staff we spoke with at the Trustees and Western about the goals of their refinancing. Western's refinancing was part of a larger bond issue to obtain new money for Adams State College and Mesa State College. According to staff, the initial reason for refinancing was for savings to be used for some critical construction needs at Western. However, we could not determine from staff or from the documentation available how much savings Western hoped to achieve from this refinancing. Additionally, we could not determine which construction projects (from a number of projects approved in program planning documents) Western planned to use the savings to complete.

As the Trustees and Western proceeded with the refinancing, market conditions changed, causing potential savings from the refinancing to decrease. Western changed its refinancing goal from achieving savings to eliminating a restrictive covenant. The covenant required Western to maintain a reserve fund of $1.2 million. As part of the refinancing, Western purchased a surety bond for $49,000 to substitute for the reserve, releasing $1.2 million.

When the goals of Western's refinancing changed, we could not determine if the projects changed or how Western selected projects in response to that change. Depending on the dollars needed and the projects selected, it had a number of options:

- **Obtaining more cash by increasing the amount of the debt.** If Western had more than $1.2 million in high-priority construction projects when the refinancing began, it could have structured its refinancing differently to obtain more cash. For example, Western paid $415,000 in issuance costs from funds it could have applied to its construction needs. Instead, it could have financed the issuance costs as part of the refinancing. This would have had minimal impact on net present value savings and would have made $1.6 million available for construction ($1.2 million plus $415,000). However, it would have also increased the amount of the debt.

- **Obtaining less cash and reducing the amount of debt.** If Western had less than $1.2 million in high-priority construction projects, it could have used part of the reserve for those projects and used the balance to reduce the amount of the debt.

- **Obtaining cash without increasing the amount of debt.** If Western had $1.2 million in high-priority construction projects but did not want to increase or reduce its debt, it could release the reserve to pay for those projects and pay the issuance costs from another related fund. This is the decision Western made.

Without clarity about refinancing goals, dollars to be achieved from the refinancing, and project priorities, we cannot determine if Western received maximum benefit from its refinancing. According to the Governmental Finance Officers Association, "an issuer contemplating an advance refunding to remove burdensome covenants or restructure debt service payments must carefully evaluate its objectives." Clarity about the goals of a specific refinancing provides criteria for evaluation at various decision points in the refinancing process, and even in changing market conditions, ensures the refinancing achieves those goals.

Determine the Preferred Approach for Realizing Savings

Governing boards and institutions should decide where they will realize their savings in their debt service schedule so that their approach is consistent with overall debt management strategies. Savings can be realized differently, depending on how the repayment schedule for the new (refinancing) bonds compares with the repayment schedule for the old (refinanced) bonds. Generally, savings are realized in three ways:

- **Taking savings at the beginning of the debt.** With this method, savings is available at the beginning of the refinancing so that institutions can use it for related purposes; for example, for constructing new or remodeling existing facilities. This method does not usually shorten the term of the debt. CSU and AHEC realized their savings in this manner.

- **Taking savings over the life of the debt.** With this method, the new repayment schedule has lower payments over the life of the debt. This method reduces the cash needed for each payment and can be helpful if an institution is having difficulty meeting its debt service coverage ratio. (Debt service coverage ratio describes the ratio of annual revenues available for paying the debt to the annual debt payment. The ratio is established in statutes and bond covenants.) Western realized its savings in this manner.

- **Taking savings at the end of the debt.** With this method, the repayment amounts are about the same, but payments are made for a shorter period of time. This shortens the term of the debt, reducing the institution's amount of debt and releasing the institution's debt capacity so that it can finance other projects if necessary. CU realized its savings in this manner.

Decisions about when savings will be realized should be consistent with how boards and institutions plan to use the savings and other proceeds from the refinancing. For example, AHEC used its savings to delay a parking fee increase; CSU used its savings to finance a remodeling project. These uses were consistent with how savings were realized, since the debt service schedule was structured to make savings available immediately. CU's debt management policies indicate that the preferred method for realizing savings is to reduce the term of the debt. Taking the savings at the end of the debt is consistent with this policy.

Again, policies addressing how savings will be realized reduce the risk that the approach and use will be inconsistent with the governing board or institution's overall debt strategy. It also provides a mechanism for clearly communicating savings preferences to the external parties that structure the debt repayment schedule.

Determine Acceptable Thresholds for Savings

Savings are the primary goal of most refinancings. Therefore, governing boards need guidelines that address the amount of savings that should result from a refinancing. This can be done by establishing the following savings thresholds:

- **Savings needed to pursue a refinancing.** This threshold is a tool for determining whether it is cost-beneficial to initiate a specific refinancing opportunity.

- **Savings needed to complete a refinancing.** This threshold is a tool for evaluating savings on or immediately before the day the issue goes to market to make sure the refinancing will meet projected savings goals.

Establishing a Savings Threshold for Pursuing a Refinancing

A common savings threshold in the professional literature is a net present value savings of 3 to 5 percent of the refinanced principal.

This savings threshold is used to evaluate a refinancing opportunity to decide if the savings will be adequate to continue pursuing it. Essentially, the threshold acts as a trigger for beginning the refinancing process. For example, if it appears that a refinancing opportunity will not produce savings equal to the threshold, the institution or board can decide not to pursue it further. A common savings threshold in the professional literature is a net present value savings of 3 to 5 percent of the old (refinanced) principal. CU's refinancing policies establish a savings threshold of 3 percent; CSU and AHEC say they have an informal threshold of 3 percent, but the threshold is not established formally in their debt management policies. Trustees and Western have not established any savings thresholds.

Several factors should be considered when establishing a threshold and evaluating refinancing opportunities against the threshold:

- **Internal costs for preparing a refinancing.** Significant time from governing board and institution staff is necessary to complete a refinancing. These costs are not considered when calculating net present value savings. Thresholds need be set high enough to cover these internal costs and still provide adequate savings to the governing board or institution.

- **Projected dollar savings from the refinancing.** Dollar savings should be considered when evaluating a refinancing opportunity against the savings threshold. A large refinancing might provide a significant net present value savings (for example, $1 million) but not reach the percentage savings threshold. It may be appropriate to proceed with the refinancing to achieve the large dollar savings. In contrast, a small refinancing may achieve the threshold but provide a small net present value savings (for example, $50,000). It may not be appropriate to pursue this refinancing since the savings may not even cover the internal costs of preparing the refinancing.

It may be appropriate to pursue a refinancing that does not meet savings thresholds, depending on the goal of the individual refinancing. This may be the case if the refinancing is being done for a reason other than savings, if interest rates are at historically low levels, or if the bonds to be refinanced are approaching their call date (a call date is the day when boards or institutions can choose to pay off the total remaining balance on the bonds).

Establishing a Savings Threshold for Completing a Refinancing

Threshold savings goals for going to market are unique to each refinancing.

This savings threshold is useful for evaluating a refinancing that is in progress to decide if the issue will achieve adequate savings if it goes to market. The threshold amount will be unique to each refinancing, depending on its purpose and goals. If the goal of the refinancing is for a purpose other than savings, the savings threshold may be very low. However, if the goal of the refinancing is to achieve savings, the threshold will likely be similar to savings projections that were estimated when the refinancing was initiated. Whether or not savings is the primary goal of a refinancing, it is still important to establish a savings threshold and monitor it throughout the refinancing process. Monitoring savings will ensure governing boards and institutions do not lose money on a refinancing.

Evaluating savings against thresholds throughout the refinancing process and on market day is especially important if interest rates have been rising. In a volatile market, a refinancing may appear to meet savings goals when initiated but may not meet savings goals when completed. If so, the governing board or institution may wish to delay the refinancing. CSU did this when, due to rising interest rates, staff realized the refinancing was not going to achieve the savings expected. CSU decided not to go to market on the day originally planned and sold its issue two months later when market conditions were more favorable.

Identify Appropriate Methods for Calculating and Evaluating Savings

Savings should be calculated net of issuance costs.

Savings can be calculated using two methods. Each method provides different savings information and can be useful to evaluate savings estimates throughout the refinancing process:

- **Present value savings.** Present value savings presents the savings from a refinancing in today's dollars. It adjusts for the fact that a dollar in the future is not worth as much as a dollar is worth today. The professional literature indicates that present value savings is the best method for evaluating savings achieved from a refinancing. Present value calculations provide a level playing field for comparing the savings from one refinancing opportunity with the savings of another. Present value savings should be evaluated in all refinancings, including those with goals other than savings. As discussed previously, this ensures boards and institutions do not lose money on a refinancing. CU, CSU, and AHEC evaluated present value savings at various points in the refinancings we reviewed; the Trustees did not.

- **Debt service savings.** This method calculates savings by comparing the total dollar value of payments under the old debt repayment schedule with the total dollar value of payments under the new debt repayment schedule. The difference is the debt service savings. This method is useful for evaluating how a refinancing will affect cash flow. CU, CSU, AHEC, and the Trustees all evaluated debt service savings during the refinancings we reviewed.

It is important that both methods be calculated net of issuance costs. There are many costs associated with refinancings, including fees for underwriters, bond counsel, financial advisors, and rating agencies. If the board or institution purchases insurance or surety bonds, these costs must be paid as well. Issuance costs can significantly reduce the savings achieved from a refinancing. If boards and institutions estimate savings from a refinancing without considering these costs, the savings will be artificially inflated. To achieve a more accurate estimate of present value and debt service savings, governing boards should calculate all estimates net of issuance costs. CU, CSU, and AHEC all calculated savings net of issuance costs; we could not determine from the documentation whether the Trustees calculated savings net of issuance costs.

Refinancing policies need to address clearly how savings should be calculated and evaluated throughout the refinancing process. This ensures that methods are applied consistently and that boards and institutions are not comparing savings that have been calculated with different or inappropriate methods.

Address Risks Associated With Advice From External Advisors

Refinancing involves financial concepts that are technically difficult. To acquire the expertise necessary to manage a refinancing, governing boards typically obtain assistance from professional external parties who operate under industry standards. These parties include:

- **Financial advisors.** Financial advisors are advocates for governing boards and institutions and are hired to represent their best interests. They work on either a fee or commission basis. They provide advice on structuring the refinancing and determining the best day to go to market. Governing boards can complete a refinancing without the participation of a financial advisor. Therefore, some boards use them and others do not.

- **Underwriters.** Underwriters sell the bonds. They purchase them from governing boards at a predetermined discount established in their contract. This discount amount is called "underwriter spread." Before the sale, underwriters determine whether there is any interest among various investors in purchasing the bonds and estimate what interest rate governing boards will have to pay on the day of sale.

- **Bond counsel.** Bond counsel review the refinancing documents to make sure the transaction and documents satisfy all legal requirements. Bond counsel are required for all revenue bond refinancings.

Underwriters generally get paid only when a refinancing issue is completed. Under certain financial arrangements, this may be the case for financial advisors as well.

Therefore, if the refinancing does not go to market, these external parties do not get paid. Boards and institutions need to develop controls to ensure that external advisors provide the best possible refinancing advice regardless of whether the refinancing does or does not go to market. This can be done through policies that address how external advisors will be used and how they will be paid.

Decide Roles for Financial Advisors and Underwriters

Governing boards and institutions we reviewed used external parties differently Each arrangement has different advantages and disadvantages, and some address risks better than others. Governing boards, in deciding how to use external parties, need to consider these advantages and disadvantages so that they can select the arrangement that best meets their needs. Arrangements we identified include:

- **Using financial advisors and underwriters in combination.** CU and CSU both have financial advisors and underwriters under contract. The financial advisors provide advice to the boards and institutions and guidance to underwriters in structuring the refinancings and determining the market date. They make sure underwriters structure the best possible refinancing issue for the governing board. The combination of financial advisor and underwriters is advantageous for boards and institutions that refinance or issue debt fairly frequently and that have complex issues.

- **Using underwriters only.** The Trustees use this arrangement. The underwriters provide financial advice, structure the refinancing, determine the market date, and sell the bonds. This arrangement can work if the board has a high level of confidence in the underwriter and staff have expertise related to issuing and refinancing debt. It is an appropriate arrangement if boards issue and refinance debt infrequently and have issues that are not overly complicated.

- **Using financial advisors as needed.** AHEC uses an underwriter for uncomplicated refinancings, but obtains a financial advisor for complex refinancings or for critical points in the refinancing process. For example, AHEC hired a financial advisor on market day only to make sure the underwriters obtained the lowest possible interest rate for one refinancing. This arrangement provides independent advice at critical points in the refinancing process. It can be advantageous for boards and institutions that refinance or issue debt infrequently.

Address Risks Through Financial Arrangements

Governing boards can address risks associated with external advisors through the methods they select for paying them. For example, CU pays its financial advisor an hourly rate with a payment cap and does not permit the advisor to underwrite the issue or receive a percentage commission when the issue is sold. CU reports this provides added assurance of independent advice. In contrast, CSU's financial advisor participates as one of the underwriters and is paid only when the bonds are sold. CSU reports this method is cost-effective, since its financial advisor offers advice without charge during and between refinancings and receives a percentage commission when a refinancing is completed. Both methods have different advantages and disadvantages, and selecting the most appropriate method depends on the expertise of staff and the frequency, size, and complexity of refinancings.

Develop Procedures for Obtaining External Advisors Efficiently

Governing boards obtain external parties through Request For Proposals (RFPs). External parties submit bids that are evaluated by board staff according to predetermined criteria. Depending on the board, RFPs are solicited to obtain external parties for each refinancing or issue or to obtain external parties for an entire contract period. CU and CSU have their external parties under contract; AHEC and the Trustees prepare separate RFPs for each refinancing or issue.

There are advantages to having external parties under contract:

- **Monitoring.** They monitor the market interest rates and inform the boards when refinancing will be advantageous. This reduces the risk boards will overlook an opportunity for savings.

- **Efficiency.** They are available immediately if a board decides to pursue a refinancing. There is no delay while boards prepare RFPs and evaluate proposals, a process that often takes four to six weeks. This is important if the refinancing is occurring during a period of fluctuating interest rates.

- **Consistency.** They are familiar with the board and institutions because they work with them on every issue and refinancing. They can structure each issue similarly to simplify debt administration.

If financial advisors under contract receive an hourly rate for certain tasks (as they do at CU), there may be some additional costs that boards who use separate RFPs do not incur. However, these costs may be outweighed by the benefit of consistent advice and reduced staff time for preparing separate RFPs, especially if the board issues and refinances debt frequently. Governing boards need to consider the advantages and disadvantages of these approaches to obtaining external advisors and address the preferred approach in their debt management policies.

Analyze Recurring Bond Issue Options Consistently

Bond issues commonly include recurring options that must be considered for each refinancing. Examples include requirements for insurance, reserves, and surety bonds. These options need to be analyzed so that boards can select the most cost-effective method for addressing them. For example:

- **Insurance**. If an institution's credit rating is less than AAA (the highest rating), it may be able to obtain a better interest rate with bond insurance than without it. (Bond insurance provides protection for the investor if the issuer defaults.) Boards need to evaluate whether savings from a lower interest rate will offset the cost of the insurance. This can be done by calculating net present value savings for the issue with and without insurance. CU did not purchase insurance for the refinancing we reviewed because it determined the cost outweighed the savings. CSU, AHEC, and the Trustees purchased insurance because the cost was offset by the savings.

- **Reserve.** When boards decide to purchase insurance, insurance companies usually require the institution to maintain a reserve account to guard against default. When evaluating the costs and benefits of purchasing insurance, boards and institutions also need to consider the disadvantages of having the cash in the reserve unavailable for the duration of the debt. This can be a significant issue for boards who are concerned about their cash flow or if they anticipate they will need the cash in the future for other needs.

- **Surety Bonds.** Insurance companies may allow boards and institutions to substitute a surety bond for their reserve account. There is a cost for the surety bond. Boards and institutions need methods to evaluate whether a surety bond is more cost-effective than maintaining a reserve. If boards decide to maintain a reserve, they may want to make sure bond provisions allow them to substitute a surety bond in the future so that they can release cash from the reserve if needed.

Governing boards can provide guidance in their policies for analyzing these recurring options. Policies can also address whether boards will use templates for covenants to standardize bond requirements for all bond issues. It is easier for boards and institutions to administer their debt if bond issues have similar covenant requirements.

Recommendation No. 2:

The Auraria Higher Education Center, the Colorado State University System, the Trustees of the State Colleges in Colorado, and the University of Colorado System should ensure their debt management strategies and policies address the critical risks related to refinancing by:

a. Identifying the roles and responsibilities of governing boards, institutions, and staff in evaluating and completing refinancing opportunities.

b. Determining and prioritizing goals for refinancings to ensure goals are in line with overall debt management strategies.

c. Determining preferred approaches for realizing savings and acceptable savings thresholds.

d. Identifying appropriate methods for calculating and evaluating savings.

e. Addressing risks associated with advice from external advisors and establishing procedures for obtaining them efficiently.

f. Addressing methods for analyzing recurring bond requirements consistently.

Auraria Higher Education Center Response:

Agree. The Auraria Higher Education Center believes that it practices most of the recommended techniques on an informal basis now, but acknowledges the desirability of formalizing these. As strategies may differ for each of three major bond issues, and as development of strategies is partially dependent on adoption of a general policy, staff limitations will probably prevent reduction of these strategies for all issues to writing prior to September 30, 1996.

Colorado State University System Response:

Partially agree. CSU believes it has, currently in place, strong strategies and procedures to address each of these issues. However, the State Board of Agriculture will review its debt management strategies and policies to verify that they are appropriate.

Trustees of the State Colleges in Colorado Response:

Agree. The Office of State Colleges will ensure that these risks, at a minimum, will be addressed during the discussions by the Board of Trustees.

University of Colorado System Response:

Agree. The Treasurer's Office will review how existing policy addresses these issues and determine beneficial modifications by July 1, 1996.

Improving Student Loan Processes

Chapter 2

Introduction

Student loans make it possible for students to complete their degrees at schools of their choice.

The federal government created the student loan program in 1965 to make it easier for low- and middle-income students to attend college. The loans make it possible for students to complete degree programs at the school of their choice. The Family Federal Education Loan Program (FFEL)--the current title for the lender-based student loan program--provides more dollars to students than any other student financial assistance program. The United States Department of Education reports that, on average, about 40 percent of all students enrolled in postsecondary schools nationwide receive loans from the FFEL program. During academic year 1995, FFEL loans amounted to about $23 billion.

State institutions of higher education play a critical role in administering federal student loan programs. Colleges and universities are responsible for processing student applications for financial assistance and for disbursing loan proceeds directly to students. Additionally, lenders have a role in the FFEL program; lenders approve and process student loan applications and send loan proceeds to the student's college or university. Guarantee agencies pay lenders for defaulted loans and attempt to collect the loans directly from students.

A number of schools across the nation reported problems administering FFEL effectively. Some of the problems have included the following:

- **Significant time is required to complete loan processes, resulting in delays for students in receiving loan proceeds.** Institutions report the time required to process loans can range from four to six weeks. In some cases students have not received loan proceeds by the first day of school.

- **Students encounter long lines on the first day of classes as they wait to pick up their checks**. Schools receive student loan proceeds through paper checks and students must pick up these checks from their institution at the beginning of each semester. As loan volumes increased, the volume of checks handled by schools also increased. Additionally, any problems occurring in the loan process (for example, the loan check had not arrived as expected) created delays as the institutions tried to help students solve problems with their loans. Loan processing problems and check volume created long lines for students.

- **Multiple paper processes involve multiple parties.** Under FFEL many processes were not automated. Numerous paper documents were transferred back and forth between schools, students, the federal government, guarantee agencies, and banks. These processes were time-consuming and documents could easily be misplaced or lost. If a problem was occurring in the loan process, it was difficult for schools to determine which party to contact to solve the problem.

These problems motivated the federal government, the State, and institutions of higher education to seek ways to improve the FFEL student loan process. Solutions have taken two forms:

- **Developing a new Direct Lending program.** The federal government, with participation from representatives from colleges and universities, developed Direct Lending--a new program for processing student loans. Initial development efforts began in 1993 and the program was implemented by fall semester of 1994. The federal government, rather than banks, is the lender. Financial aid offices at colleges and universities handle certain loan processes for the federal government, such as originating loans and issuing promissory notes. The federal government is responsible for loan repayment and collection. Additionally, it provides the software for operating Direct Lending at no cost to institutions.

- **Automating and streamlining FFEL processes.** The federal government and the Colorado Student Loan Program (the student loan guarantee agency for Colorado) developed several programs to automate portions of the student loan and financial aid processes. The federal government began developing Electronic Data Express in the late 1980s. It automates transmission of the student financial aid application. The Colorado Student Loan Program began developing E2 Disbursement Clearing House in 1989. It allows for electronic fund transfer from lenders to institutions so that colleges and universities can record tuition, fee, and other education-related payments without paper checks.

Differing Opinions Exist About the Appropriateness of Solutions

There are differing opinions at national and state levels about whether the federal government should be taking on the role of lender in the Direct Lending program (a role typically held by banks). Some argue the Direct Lending program is costing federal taxpayers more money than the FFEL program; others argue Direct Lending is costing federal taxpayers less. Additionally, lenders assert there is not a "level playing field" between FFEL and Direct Lending programs and that rules for Direct Lending are more advantageous than rules for FFEL. Our audit did not consider these issues. Our scope was limited to how state schools used these programs to improve their financial aid processes and provide better services to students. Our intent was to provide information about process improvements, cost savings, and best practices in the financial aid area for schools in Colorado to consider as they work to improve their student loan processes.

Colorado Institutions Have Applied Various Solutions To Improve Student Loan Processes

We contacted state-supported institutions of higher education in Colorado to find out how they were streamlining and improving their student loan processes. We compare their approaches in the chart on the following page.

Improvements to Financial Aid Processing Selected by Each State-Supported Institution of Higher Education in Colorado

	Direct Lending		Electronic Data Express		E2 Disbursement Clearing House	
	Implementation Complete		Implementation Complete		Implementation Complete	
	Yes	No	Yes	No	Yes	No
Adams State College			X		X	
Arapahoe Community College[1]			X			
Community College of Aurora			X		X	
Community College of Denver	X		X			
Colorado School of Mines			X			X
Colorado State University	X		X			
Fort Lewis College			X		X	
Front Range Community College[1]			X			
Lamar Community College[1]			X			
Mesa State College			X		X	
Metropolitan State College			X		X	
Morgan Community College[1]			X			
Otero Junior College[1]			X			
Pikes Peak Community College			X		X	
Pueblo Community College			X		X	
Red Rocks Community College[1]			X			
Trinidad State Junior College[1]			X			
University of Colorado- Boulder	X		X			
University of Colorado- Colorado Springs			X		X	
University of Colorado- Denver			X		X	
University of Colorado- Health Sciences Center	X		X			
University of Northern Colorado			X		X	
University of Southern Colorado			X			X
Western State College			X		X	

Source: State Auditor's Office compilation of information provided by institutions.
Notes: [1]Because Direct Lending may be repealed or participation in the program capped at current levels by Congress, these schools have decided to wait before making a decision regarding further improvements to loan processes.

The chart shows that all schools have implemented improvements to their financial aid processes and that their solutions have taken a variety of forms. We reviewed Direct Lending at two schools--the University of Colorado at Boulder and Colorado State University--and we discuss our conclusions in the first part of this chapter. We also reviewed Electronic Data Express at two different schools--Colorado School of Mines and Pikes Peak Community College--and we discuss our conclusions in the last part of this chapter.

Direct Lending Provides Benefits to Students and Schools at Minimal Cost

There are perceptions among some members of the higher education community that Direct Lending is expensive for schools to implement and maintain. Our review of Direct Lending costs at the University of Colorado at Boulder (UCB) and Colorado State University (CSU) concluded that this has not been the case for these campuses. We found:

- **Revenues and savings exceeded implementation and operation costs.** The federal government reimburses UCB and CSU for administering the Direct Lending program. Additionally, both schools have earned interest on federal funds received before the first day of class each fall and spring semester. Since the schools receive a large amount of cash from student loans earlier than they did under FFEL, they do not need to draw state-appropriated funds from the State Treasury until later in the semester. Therefore, the State Treasury earns interest on these funds until schools need them. This is a benefit for the Colorado taxpayer.

- **Direct Lending improves services to students.** Under Direct Lending, financial aid offices have more control over the loan process. Additionally, since the program involves only students, the federal government, and institutions of higher education, financial aid offices know whom to contact to solve most loan problems. UCB and CSU report they can now resolve most loan problems and disburse funds to students within 72 hours. Previously, resolving loan problems could take from four to six weeks.

- **Direct Lending has improved the efficiency of other business processes.** Since implementing Direct Lending, the Bursar's Offices at both UCB and CSU no longer need to sort and file student loan checks. This has reduced staff workloads at the beginning of each semester at each school.

Although we identified benefits from Direct Lending at these schools, we also identified some areas for improvement. Specifically, schools need to improve systems for:

- **Evaluating programs**. Both UCB and CSU need to improve data available for evaluating financial aid programs to measure shifts in workload and identify areas for improvement.

- **Tracking and estimating costs.** Some of the expenditures attributed to the Direct Lending program at CSU were for activities that were not new to Direct Lending but were for activities that also occurred under FFEL. As a result, the financial aid office requested and was authorized to spend new funds for implementing Direct Lending that it did not need.

- **Monitoring federal draw requirements and interest benefits.** CSU did not draw federal funds for Direct Lending proceeds as early as it could have during spring semester of 1995. As a result, we estimate it lost about $27,000 in interest earnings. Institutions have opportunities to maximize interest earnings from funds through good cash management and monitoring practices.

- **Tracking student comments and complaints**. CSU discontinued its processes for tracking student complaints and comments. Student comments are a good source of information on strengths and weaknesses of financial aid programs and can assist with identifying areas for improvement.

Direct Lending Revenues and Savings Exceed Costs

Our review of revenue and cost information at UCB and CSU revealed that the cost of implementing Direct Lending was significantly less than the revenues and savings generated by the program. To defray the cost of originating loans, the federal government paid schools a Payment of Originating Services (POS) of $10 per borrower. Schools also earned interest from loan proceeds. Schools generated savings by reducing temporary and full-time staff. The following chart compares ongoing and implementation costs with revenue and savings at both UCB and CSU:

Direct Lending Revenues, Savings, and Costs at UCB and CSU for Fiscal Year 1994-95		
Revenues	**Amount Earned**	
	UCB	**CSU**
Payment of Originating Services (POS)	$105,770.00	$ 94,260.00
Interest Earned on Draws	76,423.00	16,344.00
Total Revenues	**$182,193.00**	**$110,604.00**
Savings	**Amount Saved**	
2 FTE Financial Aid Office- CSU		$51,024.00
1/2 FTE Financial Aid Office- UCB	$29,924.00	
Temporary Employees Bursar's Office- CSU		3,794.00
Mailings	10,382.00	
Printing	220.00	
Total Savings	**$40,526.00**	**$54,818.00**
Costs[1]	**Amount Spent**	
One-time Costs	$23,209.00	$31,978.00
Operating Costs	7,709.00	
Total Costs	**$30,918.00**	**$31,978.00**
Total Benefit (Revenues + Savings - Costs)	**$191,801.00**	**$133,444.00**

Source: State Auditor's Office analysis of information collected from accounting systems at UCB and CSU.
[1]**Note:** Costs include only those costs over and above what schools would have spent under the FFEL program.

The chart shows that after considering implementation and operating costs, UCB and CSU received benefits valued at about $192,000 and $133,000, respectively, from their Direct Lending programs.

Revenue Earnings May Change

Although schools have earned revenues from Direct Lending, these earnings may decrease in the future for a number of reasons. First, Congress may discontinue the POS payment. However, since schools never received a similar reimbursement under FFEL and the ongoing costs for operating Direct Lending are minimal, schools indicate there will be little hardship if POS payments discontinue. Second, CSU plans to implement Automatic Clearing House (ACH) for student accounts at some point in the future. This will enable schools to deposit loan proceeds directly into student bank accounts. When ACH is fully implemented, CSU will no longer earn interest from the portion of the loan proceeds refunded to students and deposited in their bank accounts. However, CSU and the State Treasury will continue to earn interest on the early influx of cash from loan proceeds that is applied to tuition, fees, housing, and other education-related expenses.

Direct Lending Has Created Interest Revenue for the State Treasury

The State Treasury earns interest on state-appropriated funds until schools need them.

The State of Colorado also benefits from Direct Lending. Direct Lending provides a large influx of funds to UCB and CSU (about $22 million each) several days before school starts each semester. Schools report this figure is growing each year. Although institutions report some of these funds are refunded to students, more than half are retained by the institutions for tuition, fee, and housing payments. This means that schools are receiving some of their tuition, fee, and housing revenue earlier than they did in the past. As a result, schools do not need to draw their state-appropriated funds until later in the semester. This is a benefit to the Colorado taxpayer since the State Treasury earns interest on state-appropriated funds until schools need them.

Neither UCB nor CSU have systems that quantify this benefit effectively. However, our review of draw schedules for fall of 1993 shows that UCB drew 44 percent of its state appropriation by the end of December. In fall of 1994, after implementing Direct Lending, UCB drew only 20 percent of its state appropriation. The changes in the draw schedule at CSU for the same time period were not as dramatic. This is because CSU used a conservative estimate for Direct Lending funds during the first year of implementation. Additionally, the early arrival of federal funds has less impact on its cash flow since it has earlier tuition due dates than UCB and, therefore, earlier influx of cash anyway. CSU has considered the change in cash flow that occurred during the first year of Direct Lending and has adjusted its draw schedule for Fiscal Year 1996 accordingly.

Direct Lending Provides Better Service to Students

Direct Lending has also improved services to students at both UCB and CSU. For example, Direct Lending has:

- **Eliminated long lines.** Before implementing Direct Lending, schools report that students would wait in line for three to ten hours at the beginning of each semester to receive their loan checks. During fall semester of 1993, 2,466 students waited in line for loan checks at the Coors Event Center at UCB. (Students went to the Coors Event Center at the beginning of classes to resolve problems with registration, financial aid, and student accounts.) In fall of 1994 (after implementing Direct Lending) only 237 students went to the Coors Event Center to pick up loan checks. Although quantifiable data were not available, CSU also reported significant reductions in student lines after implementing Direct Lending.

- **Reduced time required to receive loan proceeds.** Under Direct Lending students can generally receive loan proceeds within 72 hours after submitting their loan applications, which is helpful when students need funds for an emergency. Previously, students had to wait four to six weeks.

- **Improved problem resolution.** Schools report that before Direct Lending, most student questions and complaints involved the location of the loan check. Since loans under the Direct Lending program are handled only by institutions and the federal government (through the U.S. Department of Education), it is much easier for schools to identify and resolve problems. Schools report that most loan problems can be resolved within 72 hours.

Direct Lending Has Improved the Efficiency of Other Business Processes

UCB and CSU reported the following improvements as a result of Direct Lending:

- **Cash Flow.** During fall semester 1994 Direct Lending enabled CSU to disburse almost $16 million to student accounts and provide almost $9 million in student refunds by the first day of classes. In fall 1993 only $2 million had been disbursed and $900,000 refunded by the first day of classes. Similarly, UCB has increased the percentage of bills collected at tuition due dates as a result of Direct Lending, as shown in the following chart.

Percentage of Outstanding Bills Collected as of the Early, First, and Second Due Dates University of Colorado at Boulder			
Due Date	**Fall 1993**	**Fall 1994**[1]	**Difference**
Early Billing	37%	50%	13%
First Due Date	59%	65%	6%
Second Due Date	94%	94%	0%
Due Date	**Spring 1994**	**Spring 1995**	**Difference**
Early Billing	32%	42%	10%
First Due Date	60%	68%	8%
Second Due Date	95%	96%	1%

Source: University of Colorado at Boulder--Bursar's Office.
Note: [1]First Year of Direct Lending.

- **Workload.** Workload at the UCB Coors Event Center decreased by 96 percent in the fall of 1994, and participation by the Bursar's Office at the Center ceased in the spring of 1995. CSU no longer hires temporary employees to handle the workload associated with distributing and cashing paper checks for student loans, saving almost $4,000 in salary costs during fall of 1994.

- **Billing and Receivable System (BRS) Payments.** UCB reports the number of BRS payments to cashiers decreased by 17 percent between fall semester 1993 and 1994. Similarly, payments decreased by 26 percent between spring semester 1994 and 1995. These decreases occurred because Direct Lending funds are disbursed directly to student accounts. CSU reports reductions in volunteers who assisted with processing paper checks for student loans at the beginning of each semester.

Improve Systems for Evaluating Programs

Both UCB and CSU could improve their systems for evaluating financial aid programs, including Direct Lending. Currently both schools have little information available for this purpose. UCB has developed a few performance benchmarks for its Direct Lending program, but these benchmarks evaluate processes that are beyond the control of the financial aid office and so are not as useful as they could be. At CSU we found that little data exist for measuring or quantifying the efficiencies or outcomes of Direct Lending; instead staff provided anecdotal evidence of program benefits based on their experience. Staff at both schools indicate they would like to improve information evaluating their Direct Lending programs.

UCB and CSU Need a Framework for Assessing the Benefits of Direct Lending

UCB and CSU need information quantifying the strengths and weaknesses of Direct Lending to make decisions about improvements to the program. For example, information evaluating Direct Lending can be used to measure shifts in current and future workload, determine areas where staff could be reduced, and identify inefficiencies in the loan process.

Without information quantifying the results of Direct Lending, schools cannot demonstrate or report on the advantages of the program adequately. Additionally, schools do not have quantifiable information on which to base decisions to enhance or modify program processes. Both UCB and CSU reported that they intend to review workloads and staff requirements in the coming year. Quantifiable data will ensure that both schools have the necessary information to make these decisions. Additionally, measurable outcome data will provide other information schools need to ensure the continued success of the Direct Lending program and would be useful to other schools in the State who are considering implementing Direct Lending.

Recommendation No. 3:

The financial aid offices at Colorado State University and the University of Colorado at Boulder should improve processes for measuring and evaluating the results of Direct Lending and other financial aid programs. Specifically, institutions should:

a. Identify the information that will be essential for resource allocation and management decisions, such as changes in workload, efficiency of processes, student satisfaction, and complaints.

b. Develop appropriate outcome measures.

c. Develop systems to collect data needed to evaluate outcomes.

d. Evaluate the data against outcome measures and use the information for resource allocation and management decisions.

Colorado State University Response:

Agree. The University agrees that appropriate outcome measurements would provide a valuable tool for evaluating the efforts of the financial aid office

University of Colorado at Boulder Response:

Agree. We will enhance our data collection that is essential to resource allocation and management decisions such as processing time for different tasks, quantity of phone calls, and assessing peak processing time in different departments.

We will assess work flow and processes in the financial aid office, so appropriate costs can be attributed to different projects and programs, and identify benchmarks that can be used to measure new processes.

We will enhance our current data collection methods and systems, so data can be easily collected and retrieved in a manner meaningful for measurements and comparisons. We will survey our customers to determine customer satisfaction with new programs and our service in general. We have already begun to implement better data collection such as: document processing time, number of and reasons for promissory note rejections by the processor, application processing time, and verification processing time. This data will be evaluated to determine resources needed at peak processing times and improve processes to eliminate errors.

For new projects, desired outcomes will be incorporated into the planning process and assessed at appropriate stages.

Improve Internal Systems for Tracking Costs

We found CSU did not have good information on what it cost to implement Direct Lending. We identified the following problems with the cost information:

- **Implementation Costs.** Actual expenditures presented to the Executive Budget Committee in April of 1995 included about $33,000 in costs for Direct Lending that the financial aid office would have incurred under the former FFEL program. In other words, these costs were not new costs.

- **Ongoing costs.** In its Fiscal Year 1996 estimate, the financial aid office identified about $9,000 in ongoing costs when these costs were actually one-time costs. These one-time costs were incurred in the previous two years and were not needed for operations during Fiscal Year 1996.

As a result, the financial aid office was authorized to spend funds it did not need to implement its Direct Lending program. The following chart compares actual expenditures attributed to Direct Lending calculated by the financial aid office with expenditures calculated by our audit team.

Expenditures for Implementing Direct Lending
Colorado State University Financial Aid Office
In Fiscal Years 1995 and 1996

Fiscal Year	Expenditures Reported by the Financial Aid Office	Expenditures Calculated by the SAO	Difference
1995 (based on actual expenditures)	$65,491	$31,978	$33,513
1996 (based on estimated expenditures)	$87,396	$24,303	$63,093

Source: State Auditor's Office analysis of information provided by CSU.

The chart shows that the financial aid office spent approximately $33,000 less on Direct Lending than it reported for Fiscal Year 1995. It also shows that the financial aid office will spend approximately $63,000 less on Direct Lending than it estimated for Fiscal Year 1996.

Accurate Cost Information Is Important for Management Decisions

The financial aid office did not have accurate cost information because adequate internal systems for tracking costs did not exist when Direct Lending was implemented. Additionally, costs were not accurate because staff planned to use some of the funds requested from the Executive Budget Committee for other financial aid activities in addition to Direct Lending. Staff indicate they will improve cost information when they complete their reorganization of the Enrollment Services Division (which includes the financial aid office). Reorganization efforts include plans to develop consistent methods for tracking and reporting cost information for all units within the Enrollment Services Division.

The difference between the dollars the financial aid office reported it spent and the dollars we calculated it spent is minimal when viewed in light of financial aid's annual budget of about $1.3 million per year. However, we are concerned that the financial aid office did not exercise sufficient care in preparing and reporting its costs to the Executive Budget Committee. The Executive Budget Committee, which must determine funding priorities and make difficult decisions about how funds will be distributed among competing and worthwhile priorities, needs good cost information to make these decisions. Additionally, the institution needs accurate cost information to plan for and evaluate the impact of its cost containment efforts. Finally, accurate cost information is useful for the financial aid office; it will need good cost information to identify the costs of program modifications and for other decisions regarding the future of Direct Lending.

Recommendation No 4:

The financial aid office at Colorado State University should improve its internal systems for tracking and reporting cost information. Specifically, the financial aid office should:

a. Conduct analyses of costs for work processes before, during, and after the implementation of projects.

b. Compare cost analyses, and identify only the new or additional costs of projects.

c. Ensure reports to the Executive Budget Committee and other decision makers identify costs accurately and appropriately.

Colorado State University Response:

Partially agree. The University agrees that the analysis provided to the auditor did not adequately account for the incremental costs/benefits of the Direct Lending program. We do not agree that a retroactive cost analysis for the Direct Lending program would be an effective use of resources at this point in time. Direct Lending, as was stated in the audit report has greatly improved the efficiency of getting loan proceeds in the hands of students at the beginning of a semester, which has considerable cost saving benefits to the students and their families. The main impetus for its implementation was to improve service to our students. The University participates in Direct Lending and other financial aid programs because approximately 65 percent of our students could not afford the cost of higher education without this support. Even if it had resulted in increased cost, the University may still have participated in the Direct Lending program because of improved service to students. The Executive Budget Committee will carefully evaluate the information provided in this audit, and take action as appropriate. See also the response in Recommendation No. 3.

Monitor Federal Draw Requirements and Interest Earnings

We estimate CSU could have earned an additional $27,000 in interest.

During spring semester 1995, CSU did not draw approximately $22 million in federal funds until 12 days before classes. Although final rules for the Direct Lending program (effective July 1, 1995) prohibit schools from drawing funds until 10 days before the first day of classes, these rules were not in effect during spring semester 1995. If CSU had drawn the funds as early as it could have (21 days before classes), we estimate it would have earned an additional $27,000 in interest revenue.

Staff reported they did not realize they could draw federal funds 21 days before classes during spring semester 1995. Additionally, staff did not calculate interest earned from these funds until we asked them to. Staff indicate they do not consider interest earnings to be a primary benefit of Direct Lending. However, interest earnings were proposed as a benefit when decision makers at CSU were deciding whether to implement Direct Lending during fall of 1993. At the time, staff estimated interest earnings would be about $26,000 per year.

Improving cash management practices and monitoring of federal regulations concerning draws will ensure CSU can take advantage of opportunities to earn interest from funds available. Additionally, monitoring interest earnings will allow CSU to more fully report and evaluate benefits incurred from Direct Lending.

Recommendation No. 5:

Colorado State University should improve its cash management practices by:

a. Monitoring federal regulations concerning draw dates.

b. Tracking interest earned from early influx of federal funds.

c. Including interest earnings as a benefit of Direct Lending when evaluating and reporting on the advantages of the program.

Colorado State University Response:

a. Agree. The University does monitor federal regulations for all programs affected by such regulations. The University was completely familiar with the regulations concerning the Direct Lending program. While there was some initial disbelief that the federal government would provide cash 21 days in advance, this was fully understood prior to drawing funds under the letter of credit. The failure was not due to the lack of familiarity with regulations or the absence of procedures to fully take advantage of potential interest earnings. CSU failed on one occasion to draw timely because of the absence of a key individual during the time it should have been processed and the failure to have adequate back-up to process the federal draw. The University will take steps to help assure this will not occur again.

b. Agree. The University does track interest revenue and can identify specific earnings due to the early influx of federal funds. In fact, we provided the data that is referenced in the audit report.

c. Agree.

Improve Systems for Tracking Student Comments and Complaints

The financial aid office at CSU does not have information available to effectively analyze comments and complaints from students about services provided. Any information on student satisfaction is primarily anecdotal and based on the recollections of staff. As a result, CSU cannot compare student satisfaction information from Direct Lending and FFEL programs as well as it could. Additionally, it cannot use student comment information as a source for identifying strengths and weaknesses of Direct Lending and other financial aid services.

In the past CSU kept a manual log of student comments and complaints, but recently discontinued this practice. CSU currently records student comments on each student's computerized loan file. Although staff can review these comments on a student-by-student basis, they cannot retrieve them easily so that the comments can be analyzed or evaluated.

In contrast, UCB has a system for tracking student phone calls and contacts that records the nature of the complaint or contact by category. Additionally, financial aid staff meet with student focus groups periodically to target problem areas in financial aid processes. UCB reports it has found its monitoring of student comments and complaints to be an inexpensive way to identify areas for improvement.

Systems for keeping track of student comments and complaints can be simple and inexpensive to implement and maintain. Additionally, they are one source of information that schools can use to identify strengths of financial aid programs and services and areas for improvement. As CSU considers changes to Direct Lending in the next year or so, it should consider developing a system for collecting and evaluating student satisfaction information and use it in its decisions about program modifications and improvements.

Recommendation No. 6:

The financial aid office at Colorado State University should improve its system for recording student complaints and comments by:

a. Developing a method for coding and categorizing student complaints and comments.

b. Periodically reviewing and analyzing the information to support decisions about directing resources, making modifications and improvements, and demonstrating program successes.

Colorado State University Response:

See response to Recommendation No. 3.

Alternatives to Direct Lending

As discussed earlier in this chapter, not all schools have addressed their problems with student loan processing by implementing Direct Lending. In fact, Direct Lending may not be an appropriate solution for some schools. At larger schools, implementing Direct Lending requires significant computer programming changes. Therefore, schools with limited staff and information system support may not have the infrastructure to support a Direct Lending program. Additionally, schools with limited experience originating loans or creating promissory notes may not have adequate internal control structures to implement Direct Lending without exposing themselves to unacceptable risks. These schools can improve their loan programs by streamlining and automating portions of the FFEL loan process.

Two of the schools that we reviewed, Colorado School of Mines (Mines) and Pikes Peak Community College (Pikes Peak), have improved FFEL loan processes through Electronic Data Express (EDE). Electronic Data Express is an electronic data exchange program developed by the United States Department of Education (Department) to help schools transmit information from the student financial aid application (Free Application for Federal Student Aid or FAFSA) to the Department electronically. The Department uses the FAFSA to determine student eligibility for federal financial aid.

Electronic Data Express Provides Benefits

Our review concluded that EDE provided a number of benefits to Mines and Pikes Peak:

- **EDE was implemented at minimal cost.** Pikes Peak and Mines spent about $4,300 and $180, respectively, implementing EDE. They plan to spend about $2,300 and $500, respectively, on transmission costs each year. Implementation costs were higher at Pikes Peak because it purchased a new computer and printer. Transmission costs will be higher at Pikes Peak because it is a larger school and the transmission fee is based on the number of transmissions.

- **EDE reduces the time required to correct and transmit financial aid applications (FAFSAs).** Students send completed FAFSAs to the Department of Education so it can determine eligibility for federal financial aid. If the FAFSA contains an error, the Department informs the school electronically through EDE. EDE allows the school to correct the FAFSA on its computer and transmit the corrected information back to the Department electronically. Within 48 to 72 hours the Department uses EDE to inform the school whether the student is eligible for financial aid. The school can then create the student's financial aid package.

  In the past, schools made these corrections manually. Depending on the number of corrections, it could take up to six weeks before the Department could notify the school of the student's eligibility. The following chart shows the number of corrections completed electronically through EDE during the past and current year. These are corrections that would have been done manually before EDE was implemented.

Corrections Entered on Electronic Data Express		
School	Academic Year 1994-1995	Academic Year 1995-1996
Colorado School of Mines	246	223*
Pikes Peak Community College	186	553*

Source: Colorado School of Mines and Pikes Peak Community College.
*These numbers are for part of a year and are expected to increase.

- **EDE saves staff time.** EDE can run independently on a personal computer or can interface with a mainframe. The mainframe interface allows schools to update both EDE and mainframe records simultaneously. Both Pikes Peak and Mines report this reduces errors and saves staff time. Mines estimates it saves about 340 hours per year from its EDE mainframe interface.

- **EDE eliminates barriers for students who miss application deadlines.** EDE enables schools to transmit entire FAFSA applications electronically when necessary. Therefore, when students apply for admission after financial aid application deadlines, they can still obtain financial aid in time to enroll in school. Pikes Peak reports that some of its students do not decide to attend school until the first day of class. With EDE these students can still be considered for financial aid. Pikes Peak reports it transmitted entire FAFSA applications for 144 students during July and August of this year.

E2 Disbursement Clearing House Streamlines Student Loan Processes

Schools also have opportunities to improve their student loan processes through a program entitled "E2 Disbursement Clearing House" or E2. This program, developed by the Colorado Student Loan Program (CSLP) at the Department of Higher Education, streamlines the transfer of FFEL funds. Both Pikes Peak and Mines plan to implement E2 during the 1995-96 academic year. Although we did not review E2 at either Pikes Peak or Mines, the Colorado Student Loan Program provided us with some information. According to CSLP, the E2 program provides:

- **More institution control over FFEL loan processes at minimal cost.** Like Direct Lending, institutions can use E2 to operate a campus-based student loan program. However, loans are funded by private lenders instead of the federal government. The Colorado Student Loan Program offers the E2 process to institutions at no cost.

- **Electronic funds transfer and streamlined business processes.** E2 allows loan proceeds to be transferred electronically from lenders to institutions (through CSLP), eliminating paper checks. Schools can then apply loan proceeds directly to student accounts to pay tuition, fees, and other education-related expenses. Loan adjustments, cancellations, and refunds can also be accomplished electronically. Students do not have to wait in line to receive their loan checks; manual processes for endorsing and cashing paper checks are eliminated.

According to CSLP, the combination of EDE and E2 programs will significantly improve the automation of FFEL student loan processes. These two programs provide alternatives for schools who want to improve their student loan programs but do not want to implement Direct Lending.

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