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# **Audit Of The Colorado Student Loan Program's Establishment And Use Of Federal And Operating Funds For The Federal Family Education Loan Program**

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## **FINAL AUDIT REPORT**



**ED-OIG/A07-C0009**

**July 2003**

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U.S. Department of Education  
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# Audit Of The Colorado Student Loan Program’s Establishment And Use Of Federal And Operating Funds For The Federal Family Education Loan Program

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## Table of Contents

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Executive Summary.....	1
Audit Results.....	2
Finding No. 1 – CSLP Improperly Transferred Approximately \$1.63 Million From The Federal Fund To The Operating Fund.....	2
Finding No. 2 – CSLP Improperly Allocated A Reimbursement For Indirect Costs Incurred By Its Loan Servicing Unit.....	4
Finding No. 3 – CSLP Used Federal Funds To Pay For Unallowable Expenditures.....	5
Finding No. 4 – CSLP Miscalculated The Beginning Balance Of The Federal Fund.....	7
Background.....	8
Objective, Scope, And Methodology.....	9
Statement On Management Controls.....	11
Appendix – Colorado Student Loan Program Response To The Draft Audit Report.....	12

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# Audit Of The Colorado Student Loan Program's Establishment And Use Of Federal And Operating Funds For The Federal Family Education Loan Program

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## Executive Summary

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The Colorado Student Loan Program (CSLP) did not fully comply with the Higher Education Act of 1965 as amended (HEA) and applicable regulations in the establishment of Federal and Operating Funds for the Federal Family Education Loan (FFEL) Program. We found the following occurred during our audit period, July 1, 1998 through June 30, 1999:

- CSLP improperly transferred approximately \$1.63 million from the Federal Fund to the Operating Fund for a working capital reserve.
- CSLP improperly allocated a reimbursement for indirect costs incurred by its Loan Servicing Unit (LSU), resulting in a \$302,824 understatement in the Federal Fund.
- CSLP used Federal funds to pay for unallowable expenditures, resulting in a \$236,078 understatement of the beginning balance of the Federal Fund.
- CSLP miscalculated the beginning balance of the Federal Fund, resulting in a \$36,131 understatement in the beginning balance of the Federal Fund.

We recommend that the Chief Operating Officer (COO) for Federal Student Aid (FSA) require CSLP to return to the Federal Fund the \$547,185 in remaining applicable imputed interest on all findings.

In its response to our draft report, CSLP agreed with Findings 2, 3, and 4 but disagreed with Finding 1. In addition, CSLP did not agree with the rate we used to calculate imputed interest due to the Federal Fund. CSLP provided documentation that it had repaid the \$1.63 million we cited in Finding 1 as well as the remaining balance of the \$10.9 million it had transferred for a working capital reserve. We have summarized its responses at the end of the respective findings and provided the full text of the responses as an appendix to this report.

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## Audit Results

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The objective of the audit was to determine whether CSLP complied with the HEA and regulations governing the establishment and maintenance of its Federal and Operating Funds. Within the scope and limitations of the audit, we concluded that CSLP complied with these federal requirements with the exception of the findings documented in this report. We found that CSLP inappropriately used loan-servicing expenditures to calculate the amount of funds it transferred from the Federal Fund, resulting in a transfer of approximately \$1.63 million in excess of the amount allowed by the HEA. We also found that CSLP did not deposit approximately \$302,824 due to the Federal Fund. This occurred because CSLP did not properly allocate and deposit a portion of an indirect cost reimbursement from the LSU into the Federal Fund. CSLP also used reserve funds to pay for approximately \$236,000 of unallowable expenditures and miscalculated the beginning balance of the Federal Fund due to a spreadsheet error.

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### Finding No. 1 – CSLP Improperly Transferred Approximately \$1.63 Million From The Federal Fund To The Operating Fund

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CSLP transferred a total of approximately \$10.9 million from the Federal Fund to the Operating Fund as a working capital reserve under § 422A(f)(1) of the HEA when it established the funds on December 2, 1998. The HEA limited the allowable transfer to 180 days' cash expenses for normal operating expenses to perform the duties of the guaranty agency. CSLP exceeded the limit by approximately \$1.63 million when it improperly included the expenses of the LSU, a separate unit detached from any fiscal relationship with CSLP's guaranty operations.

According to 34 C.F.R. § 682.421 (b)(1), a guaranty agency "may transfer an amount up to the equivalent of 180 days of cash expenses for purposes allowed by §§ 682.410 (a)(2) and 682.418 (not including claim payments) for normal operating expenses to be deposited into the agency's Operating Fund." The federal regulations in 34 C.F.R. § 682.410 (a)(2)(ii) provide that a guaranty agency must use the assets of the reserve fund to pay only costs that are reasonable, as defined under 682.410(a)(11)(iii), and that are ordinary and necessary for the agency to fulfill its

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responsibilities under the HEA. The regulations in 34 C.F.R. § 682.410 (a)(11)(iii)(B) state that, in determining the reasonableness of a cost, consideration must be given to factors such as the terms and conditions of the guaranty agency's agreements with the Secretary.

In a November 6, 1998, letter to the U.S. Department of Education (the Department), CSLP requested fiscal separation of the LSU from CSLP guaranty operations. The letter pointed out that since the early years of the LSU it had been self-sustaining and had not been subsidized by federal funds. A subsequent letter from CSLP to the Department documents a November 9, 1998, agreement between the Department and CSLP allowing for the separation CSLP had requested.

By using the LSU expenditures in the 180-day expenditure calculation, CSLP exceeded the amount of funds it could transfer from the Federal Fund to the Operating Fund. The transfer (or loan) from the Federal Fund should not have exceeded \$9,290,167.52 (\$10,921,058.47 - \$1,630,890.95) because LSU expenditures were not reasonable and necessary for CSLP to fulfill its responsibilities under the HEA.

## Recommendation

We recommend that the COO for FSA require CSLP to

- 1.1 Reimburse the Federal Fund \$451,824 of imputed interest on the amount improperly transferred calculated through June 30, 2002.<sup>1</sup>

**CSLP Comments** – CSLP contested the propriety of this finding. CSLP stated that at the time of the transfer of funds from the Federal Fund to the Operating Fund there were no regulations implementing §422A (f)(1) of the HEA, as amended by the 1998 amendments. In addition, CSLP stated that the statute does not specify that the amount of any loan must relate to expenses for guaranty activities only and that a program review by the Financial Partners Channel of the Department resulted in no adverse findings related to the establishment of the Funds. CSLP provided additional information to evidence that the initial transfer of the monies from the Federal Fund to the Operating Fund to establish a working capital reserve were completely repaid on September 10, 2002.

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<sup>1</sup> Throughout this report, imputed interest has been calculated by using the U.S. Department of the Treasury's Current Value of Funds rate.

**OIG Response** – CSLP’s comments did not alter our overall position on the allowability of its transfer of \$1,630,891 from the Federal Fund to the Operating Fund. However, we modified the requested reimbursement amount in the recommendation to reflect CSLP’s complete repayment of the principal amount in question (\$1,630,891). While regulations regarding the matter of such transfers were not issued until after December 1998, pre-existing regulations support our position on the subject transfer. Allowable transfers are limited by § 422A (f)(1) of the HEA to a portion of the “normal operating expenses” of a guaranty agency, which are defined in 34 C.F.R. § 682.410 (a)(1) as expenses relating to “guaranty activities.” Such expenses are defined more specifically by 34 C.F.R. §§ 682.410 (a)(2)(ii) and 682.410 (a)(11)(iii), as discussed in this finding. The transfer amount was not reasonable and necessary considering the terms of the guaranty agency’s LSU separation agreement with the Department.

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## Finding No. 2 – CSLP Improperly Allocated A Reimbursement For Indirect Costs Incurred By Its Loan Servicing Unit

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CSLP did not properly account for the Federal Fund's portion of the LSU payment for indirect costs allocated to it in FY 1999.<sup>2</sup> CSLP allocated its central service department costs, such as accounting, legal, and human resource expenses, to various departments within CSLP. Our review of CSLP’s cost allocation plan showed that CSLP billed its LSU for FY 1999 indirect costs in accordance with OMB Circular A-87. However, it did not credit the Federal Fund as required.

The HEA provides that the Department may not regulate the uses or expenditures of moneys in the Operating Fund unless a transfer under § 422A (f)(1) of the HEA is outstanding from the Federal Fund. Since CSLP has not repaid the transfer from the Federal Fund, it is subject to the cost allocation plan requirements of 34 C.F.R. § 682.418 (c), which provide that a guaranty agency must follow the cost allocation requirements described in OMB Circular A-87. OMB Circular A-87, Section C.4.a. provides that, “[t]o the extent that [applicable] credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.” This same section of the Circular defines applicable credits as “those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs.”

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<sup>2</sup> Throughout this report, fiscal years refer to the fiscal year designated by the State of Colorado, which extends from July 1 through June 30.

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On July 23, 1999, CSLP transferred approximately \$1.2 million from the LSU Fund to the Operating Fund for LSU indirect costs. A portion of the FY 1999 indirect costs incurred by the LSU (covering the period July 1998 through September 1998) was paid from reserve funds. At the end of FY 1999, CSLP should have prorated the indirect cost reimbursement from its LSU between the Federal and Operating Funds. Instead, the full amount went to the Operating Fund.

## Recommendation

We recommend that the COO for FSA require CSLP to

- 2.1. Reimburse the Federal Fund for the remaining \$46,729 in imputed interest calculated through June 30, 2002.

**CSLP Comments** – CSLP agreed with our finding. CSLP stated that the pro-ration should have occurred and that it made a transfer of one quarter of the indirect costs for FY 1999, in the amount of \$302,824, from the Operating Fund to the Federal Fund. CSLP provided documentation that this reimbursement occurred on June 30, 2002. CSLP agreed that additional interest might be owed to the Federal Fund; however, it believed that the interest rate should be based on the actual interest paid by the Colorado State Treasury.

**OIG Response** – Our review of CSLP’s comments did not change our position. The Treasury Current Value of Funds rate is specified by the Debt Collection Act of 1982, 31 U.S.C. 3717, as the minimal rate of interest for debts owed the Government.

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## Finding No. 3 – CSLP Used Federal Funds To Pay For Unallowable Expenditures

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CSLP used reserve funds for two expenditures that were not allowable or allocable to the reserve fund after September 30, 1998. This resulted in an understatement of the Federal Fund amounting to \$236,078. The expenditures were unallowable under 34 C.F.R. § 682.410 (a)(2)(ii), which provides that reserve fund assets may only be used to pay those costs that are allocable to the FFEL Program.

Both expenditures were made using reserve funds before the new Federal and Operating Funds were established, and they both involved payments that were made for costs not allocable to the FFEL Program.

- On September 30, 1998, CSLP paid \$132,077 to the State of Colorado for liability and worker's compensation insurance for the fiscal year ending June 30, 1999. Although the State only requested that CSLP pay \$33,019 for the insurance for the first quarter of FY 1999, CSLP paid the entire amount. CSLP made the payment with federal reserve funds and made no adjustment when it established the Federal and Operating Funds for the amount that covered the period from October 1, 1998, to June 30, 1999. The result of CSLP's failure to adjust for the payment that had been made for the last nine months of FY 1999 was that the opening balance of the Federal Fund was understated by \$99,058 (\$132,077 less \$33,019).
- On September 30, 1998, CSLP paid \$137,020 for computer programs and licenses. Since this expense was for licenses from November 1, 1998, through October 31, 1999, it should have been charged to the Operating Fund. CSLP paid the amount from federal reserve funds prior to October 1, 1998. CSLP made no adjustment when it established the Federal and Operating Funds for these licenses. The result of CSLP's failure to adjust for these payments was that the opening balance of the Federal Fund was understated by \$137,020.

## Recommendation

We recommend that the COO for FSA require CSLP to

- 3.1. Reimburse the Federal Fund \$47,460 for imputed interest on the unallowable expenditures calculated through June 30, 2002.

**CSLP Comments** – CSLP agreed with our finding. CSLP stated that FY 1998 was the first time that the State allowed quarterly payment of the insurance and that CSLP had elected to continue to pay it annually. CSLP also stated that the contract for the software licenses was approved on September 25, 1998, and due to anticipated deadlines, the software needed to be installed immediately. CSLP provided documentation that it transferred a total of \$236,078 for these expenses from the Operating Fund to the Federal Fund on June 30, 2002. CSLP agreed that additional interest might be owed to the Federal Fund; however, it believed that the interest rate should be based on the actual interest paid by the Colorado State Treasury.

**OIG Comments** – Our review of CSLP’s comments did not change our position. The Treasury Current Value of Funds rate is specified by the Debt Collection Act of 1982, 31 U.S.C. 3717, as the minimal rate of interest for debts owed the Government.

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## Finding No. 4 – CSLP Miscalculated The Beginning Balance Of The Federal Fund

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CSLP made an error in calculating the amount needed to establish the Operating Fund. We found a \$36,131 transfer to the Operating Fund that was not supported. CSLP explained that it had made an error on the spreadsheet CSLP used to calculate the beginning balance of the Operating Fund. A formula in the spreadsheet picked-up the date, 12/02/98, and interpreted it as a dollar amount, resulting in an error of \$36,131. As a result, the beginning balance of the Federal Fund was understated by \$36,131. We calculated that CSLP owed the Federal Fund an additional \$8,884 in imputed interest on this amount calculated through March 31, 2002. Not correcting such an error would be inconsistent with sound business practices, as required by 34 CFR § (a)(11)(iii)(B).

### Recommendation

We recommend that the COO for FSA require CSLP to

- 4.1 Reimburse the Federal Fund for the remaining \$1,172 in imputed interest on the spreadsheet error calculated through March 31, 2002.

**CSLP Comments** – CSLP agreed with this finding but disagreed with the OIG recommendation as to the amount of imputed interest that should be transferred from the Operating Fund to the Federal Fund. CSLP stated that it had made its interest calculations on the interest paid by the State Treasury.

**OIG Response** – Our review of CSLP’s comments did not change our position. The Treasury Current Value of Funds rate is specified by the Debt Collection Act of 1982, 31 U.S.C. 3717, as the minimal rate of interest for debts owed the Government.

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## Background

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### Federal And Operating Funds

The Higher Education Amendments of 1998, enacted October 7, 1998, required each guaranty agency to establish a Federal and Operating Fund within 60 days of enactment. All funds, securities, and other liquid assets previously held in an agency's reserve fund were to be deposited into a Federal Student Loan Reserve Fund (Federal Fund) by December 6, 1998.

The Federal Fund, which is used to pay lender claims and default aversion fees, is the property of the Department. The Operating Fund is used to pay for application processing, loan disbursement, enrollment and repayment status management, and other guaranty agency activities. It is the property of the guaranty agency, except for any funds it may contain by means of transfer from the Federal Fund. Funds transferred from the Federal Fund remain the property of the Department and use of the Operating Fund is restricted by federal regulations.

### The Colorado Student Loan Program

CSLP is the designated guaranty agency for Colorado and is located in Denver. It is a state agency. CSLP established its Federal and Operating Funds on December 2, 1998. Its Operating Fund contains funds transferred from the Federal Fund and is therefore subject to all of the regulations under 34 C.F.R. § 682.418.

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## Objective, Scope, And Methodology

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The objective of the audit was to determine whether CSLP complied with the HEA and regulations governing the establishment and maintenance of its Federal and Operating Funds. The period covered by the audit extended from July 1, 1998, through June 30, 1999, with the exception of the review of the usage fees, which extended from July 1, 2000, through June 30, 2002. To accomplish our objective, we reviewed FY 1999 accounting records relevant to the establishment, maintenance, and transfer of Federal and Operating Funds.

To review the establishment of the funds, we judgmentally selected 14 of 321 deposits and 9 of 634 expenditures with amounts exceeding \$10,000 that were recorded in the Federal Fund prior to and immediately following the establishment of the fund. We also judgmentally selected 3 of 75 deposits and 16 of 109 expenditures with amounts exceeding \$10,000 that were recorded in the Operating Fund prior to and immediately following the establishment of the fund. We judgmentally selected 5 of 188 Federal Fund deposit records and 12 of 884 Federal Fund expenditure records with amounts over \$10,000 for further review of maintenance of the fund. We also judgmentally selected 10 of 568 Operating Fund deposit records and 12 of 182 Operating Fund expenditure records with amounts over \$10,000 for further review of the maintenance of the fund. We judgmentally selected records for testing based on our perception of which ones were most susceptible to errors and would have the most impact on the balance of the Federal Fund.

We reviewed CSLP's cost allocation plan and related deposits and expenditures for State FYs 1998 and 1999. We also reviewed CSLP records with respect to non-liquid assets, usage fees, and investment and repayment of funds transferred from the Operating Fund to the Federal Fund. We reviewed CSLP's financial and single audit reports for FY 1999 as well as the supporting working papers of the independent public accountant that performed the audits. We interviewed various CSLP personnel and FSA officials.

To achieve our objective, we relied on data from the Colorado Financial Reporting System (COFRS) automated accounting system. To assess the reliability of this data, we reviewed work completed by the independent public accountant and conducted additional tests. We tested the accuracy, authenticity, and completeness of the COFRS data by comparing the data to source

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records. We concluded that the data contained in the COFRS accounting system were sufficiently reliable to be used in meeting the audit's objective.

We performed on-site fieldwork at CSLP offices periodically from January to June 2002, and continued to collect and analyze data in our offices through October 2002. We held an exit conference with officials of CSLP on November 4, 2002, and issued a draft audit report on April 17, 2003. We received CSLP's comments on the draft report on May 12, 2003, and clarifying information from CSLP on June 17, 2003. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.

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## Statement On Management Controls

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As part of our audit, we made an assessment of CSLP's management control structure, policies, procedures, and practices applicable to CSLP's establishment and use of the FFEL Federal and Operating Funds. The purpose of our assessment was to assess the level of control risk, that is, the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of the substantive tests needed to accomplish our audit objectives.

To make our assessment, we identified significant controls and classified them into the following categories:

- Establishment of the Federal and Operating Funds;
- Maintenance of the Federal and Operating Funds;
- Ownership of fixed assets used to administer the FFEL Program;
- Transfers of assets from the Federal Fund to the Operating Fund;
- Transactions involving the federal reserve fund, prior to the establishment of the Federal and Operating Funds, that significantly impacted the opening balances of those funds; and
- Conflict of interest standards.

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in CSLP's procedures used to establish the Federal and Operating Funds as well as weaknesses in transactions involving the federal reserve fund prior to the establishment of the funds. We describe the weaknesses in the Audit Results section.

# **Appendix**

## **CSLP Comments On The Draft Report**

# STATE OF COLORADO

Department of Higher Education  
COLORADO STUDENT LOAN PROGRAM



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Re: Draft Audit Report (Control Number ED-OIG/A07-C0009)

Dear Mr. Allen:

The following are the Colorado Student Loan Program ("CSLP") comments to the Findings raised in the above-referenced Report:

1. Finding #1: CSLP Improperly Transferred Approximately \$1.63 Million From The Federal Fund To The Operating Fund
  - a. CSLP contests the propriety of Finding # 1 for the following reasons:
    - (1) On December 2, 1998, CSLP transferred the contested amount from its Federal Fund to its Operating fund pursuant to provisions of §422A(f)(1) of the Higher Education Act, as amended by the Reauthorization Amendments of 1998. This statutory provision specified that the transfer in question could be in an amount covering "... not more than 180 days cash expenses for normal operating expenses (not including claim payments) as a working capital reserve as defined in Office of Management and Budget Circular A-87 (Cost Accounting Standards) ... for use in the performance of the guaranty agency's duties under this part."
    - (2) At the time of the transfer, there were no regulations implementing §422A(f)(1). More specifically, 34 CFR §682.421, cited as the basis for the contested Audit Finding, did not exist, was not promulgated until October 29, 1999 (one year after the effective date of the statute), and did not take effect until July 1, 2000 (approximately 19 months after the transfer was made). Therefore, that regulation cannot appropriately be considered to govern the transfer made 19 months before it took effect. Only the statute can legitimately be considered to have governed the transfer; and the statute does not specify that the amount of any loan must relate to 180 days of expenses for guarantee activities, only. Further, all CSLP loan servicing activity at

the time of the transfer was then, and still is, now, considered by both CSLP and the Department, to be a Federal Fund activity, and CSLP's Loan Servicing Department was then, and still is, now, considered to be an asset of the United States, and both will remain so until CSLP and the Department reach agreement on a "buy-out" - an action CSLP has attempted to accomplish for the last five years.

- (3) Further, during the period of December 4 - 7, 2000, the Partner Services Unit of the Financial Partners Channel of the Department of Education conducted a Program Review (No. 20011096011) of CSLP that, *inter alia*, reviewed the manner in which CSLP established its Federal and Operating Funds on December 2, 1998. That Review resulted in no adverse findings related to establishment of either of those Funds.

Accordingly, the amount specified in Finding # 1 should be deducted from the total amount recommended to be returned to the Federal Fund by the Draft Audit Report.

- b. Even if the Department adheres to its position that Finding # 1 is appropriate, CSLP points out that the contested amount of money should be considered by the Department to have been previously repaid--in part on November 28, 2001 (when CSLP made a transfer from its Operating Fund into its Federal Fund in the amount of \$1,213,450.94 in partial repayment of the original transfer), and completely repaid, with any interest due, on December 6, 2001 (when CSLP made another transfer from the Operating Fund to the Federal Fund of an additional \$1,000,000). Accordingly, the amount specified in Finding #1 should be deducted from the total amount recommended to be returned to the Federal Fund in the Draft Audit Report. Double repayment of the principal as directed in the finding is not an appropriate penalty in this circumstance.
  - c. Finally, even if the Department continues to adhere to the position that Finding #1 is appropriate, and views that the contested amount of the subject transfer was not completely paid, with interest, on December 6, 2001, then CSLP points out that the entire initial transfer establishing the Operating Fund, including the principal of the contested amount) was completely repaid when CSLP made its last transfer from the Operating Fund to the Federal Fund on September 10, 2002 in repayment of the Operating Fund loan. Accordingly, the amount of allegedly improper principal transfer specified in Finding #1 should be deducted from the total amount recommended to be returned to the Federal Fund by the Draft Audit Report. Again, it is CSLP's contention that requiring a second repayment of the principal borrowed is an inappropriate sanction.
2. Finding #2: CSLP Improperly Allocated A Reimbursement For Indirect Costs Incurred by Its Loan Servicing Unit.

CSLP agrees that this pro-rata should have occurred and has previously made a transfer of one quarter of the indirect costs for 7/1/98 to 9/30/98 in the amount of \$302,824 from the operating fund to the federal fund.

3. Finding #3: CSLP Used Federal Funds To Pay For Unallowable Expenditures.

The \$132,077 payment to the State of Colorado for liability and property insurance for the fiscal year ending 6/30/99 was paid according to our normal practice for that expenditure. Prior to and including FY97, the state invoiced and expected payment for the entire year period. FY 98 (7/97 to 6/98) was the first time the State allowed quarterly payment of the insurance and CSLP elected to continue to pay annually.

The \$132,020 payment to SAS Institute for software licenses for the period of 11/1/98 to 10/31/99 made on September 30, 1998 occurred as a result of executing a contract for annual licensing of software that was necessary to convert to a new guarantee system being developed at the time by PHEAA. The contract was approved on 9/25/98 and due to anticipated conversion deadlines CSLP needed to install the software immediately, which was done. The contract Attachment A, Section 2.1 provided for one month of free trial usage (October 1998) prior to the beginning of the license in November.

CSLP has transferred \$99,057.75 for liability insurance and \$137,020 for the SAS payment from the operating fund to the federal fund.

4. Finding #4: CSLP Miscalculated The Beginning Balance Of The Federal Fund.

The \$36,131 error was a result of including a date field in the formula used to calculate the beginning balances. Upon notice, CSLP returned these funds to the federal fund.

While we agree that for findings #2 and 3 additional interest may be owed, we do not agree with the amounts you are requesting. Using the actual interest paid during the time periods involved, we cannot duplicate your calculations for interest earnings to be returned to the fund.

Finding #4, for example, states that additional interest is due in the amount of \$1,172. We dispute that additional interest is owed and have already repaid \$7,712 in interest. All of our interest calculations are based on the actual interest paid by State Treasury, which is where the federal funds are deposited.

If you could provide us information on how you calculated interest (rates used and elapsed times) and why your calculations were not based on the actual interest rates paid, perhaps we can reach agreement on the amount of additional interest owed.

Please let me know if I can provide additional or clarifying information.

Sincerely,

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Jeanne M. Adkms  
Director

CC: Chuck Heim  
Robert Haddock

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Establishment And Use Of Federal And Operating Funds For The  
Federal Family Education Loan Program**

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