

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
Denver, Colorado**

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

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COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
FINANCIAL AUDIT
June 30, 2002

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Members of the Legislative Audit Committee:

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

Clifton Henderson LLP

Greenwood Village, Colorado
August 28, 2002

REPORT SUMMARY

COLORADO STUDENT OBLIGATION BOND AUTHORITY SCHOLARS CHOICE FUND FINANCIAL AUDIT FISCAL YEAR ENDED JUNE 30, 2002

Purpose and Scope

The Office of the State Auditor, State of Colorado, engaged Clifton Gunderson LLP to conduct the financial audit of the Colorado Student Obligation Bond Authority (Authority) Scholars Choice Fund (Scholars Choice Fund) for the fiscal year ended June 30, 2002. Clifton Gunderson LLP performed this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

Audit Opinions and Reports

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

Summary of Key Findings and Recommendations

Finding No. 1 – Billings to Third Party

The Authority has entered into a Financial Institution Services Agreement with Salomon Smith Barney Inc. (SSB) which outlines the services SSB is to provide the Scholars Choice Fund including investment management services, marketing services and administrative services. The Authority is to bill SSB for a portion of expenses it incurs in administering the Scholars Choice Fund on a monthly basis. We noted that the Authority is not billing in accordance with the terms of the agreement. We recommend the Authority begin monthly billing of expenses to be reimbursed.

The Authority agreed with the recommendation and intends to begin monthly billing of expenses commencing in October 2002.

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

Required Communication

Management Judgments and Accounting Estimates. There were no significant accounting estimates of financial data which would be particularly sensitive and require substantial judgment by management.

Significant Audit Adjustments. One adjustment was made during the completion of fieldwork. The adjustment was to record additional salaries, benefits and general and administrative expenses of \$189,473 and reimbursement revenue of the same amount resulting from the change in the allocation of the direct and indirect costs. See Finding No. 1 for additional information.

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

**DESCRIPTION OF THE
COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND**

Organization

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

Scholars Choice Fund

The Scholars Choice Fund was established in October 1999 to provide families with an opportunity to save for future college education expenses. The Program provides an opportunity to invest on a tax-favored basis toward the “qualified higher education expenses” of a designated beneficiary (the Student) associated with attending an institution of higher education. These institutions include most community colleges, public and private four-year colleges, universities, graduate and post-graduate programs, and certain proprietary and vocational schools. “Qualified higher education expenses” include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a Student at an eligible institution of higher education plus, subject to certain limitations, room and board expenses for a student attending such an institution on at least a half time basis.

The Scholars Choice Fund had more than 88,500 active accounts as of June 30, 2002. Officials at the Authority oversee the Fund but contract with a private financial service firm, Salomon Smith Barney, Inc., to manage the Fund.

Scholars Choice accounts can be opened any time during the year. At the time an account is established, the purchaser must select from five investment options. Investors are allowed to change their investment within the Fund once every twelve months. Below are the five investment options.

- **Age Based Option** – Contributions are invested in a series of portfolios over time. As the beneficiary gets older and closer to college age, the fund manager automatically moves investments from higher risk portfolios to lower risk portfolios.
- **Balanced Option** – Contributions are invested in a portfolio with a median degree of risk, with 50% invested in stocks and 50% invested in bonds.
- **Years-to-Enrollment Option** – Contributions are invested in a series of portfolios depending on the time to account for maturity, similar to the age based option, but with a more limited, lower risk, range of portfolios.

- **All Equity Option** – Contributions are invested in equity mutual funds throughout the life of the account. This option carries the highest potential for risk and return through its focus on the equity markets.
- **Fixed Income Portfolio** – Contributions are invested in bond funds throughout the life of the account. This option seeks stable returns on fixed income investments.

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

FINDINGS AND RECOMMENDATIONS

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

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

FINDING NO. 1 – Billings to Third Party

The Authority has entered into a Financial Institution Services Agreement with Salomon Smith Barney Inc. (SSB) which outlines the services SSB is to provide to the Scholars Choice Fund including investment management services, marketing services and administrative services.

Under the terms of the agreement, the Authority is entitled to an administrative fee for the payment of the direct and indirect costs and expenses of the Authority incidental to the performance of the Authority's duties and obligations in connection with the Scholars Choice Fund. SSB is required to withdraw from the Scholars Choice Fund and pay to the Authority up to .10% of the average daily net assets of Scholars Choice to cover the administrative fee. In addition, SSB has agreed to reimburse the Authority out of its own assets up to .20% of the average daily net assets of the Fund. In order for the Authority to receive reimbursement, it is required to deliver to SSB on or before the 15th day of each month a statement of the Authority administrative fee due.

During our audit we noted that the Authority is remitting monthly billings to Scholars Choice which represents .10% of the average daily net assets. However, the billings to SSB for .20% of the average daily net assets are not being billed on a monthly basis in accordance with the terms of the agreement. The Authority has billed SSB and has recorded a receivable and revenue of \$189,473 for costs incurred during the fiscal year ended June 30, 2002.

RECOMMENDATION

We suggest the Authority submit expenses for reimbursement to SSB in accordance with the agreement.

AUTHORITY'S RESPONSE

The Authority intends to begin monthly billings of expenses commencing in October 2002.

Independent Auditor's Report

Members of the Legislative Audit Committee:

We have audited the accompanying statement of fiduciary net assets of the Colorado Student Obligation Bond Authority (a division of the Department of Higher Education, State of Colorado) Scholars Choice Fund (Scholars Choice Fund) as of June 30, 2002 and 2001, and the related statement of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Colorado Student Obligation Bond Authority, Scholars Choice Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

In our opinion, the financial statement referred to above presents fairly, in all material respects, the net assets of Colorado Student Obligation Bond Authority, Scholars Choice Fund as of June 30, 2002 and 2001, and the changes in net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2002, on our consideration of the Colorado Student Obligation Bond Authority, Scholars Choice Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an internal part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

The Management's Discussion and Analysis (MD&A) on pages 10 to 13, is not a required part of the financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for the purposes of additional analysis and is not a required part of the basic financial statements of the Colorado Student Obligation Bond Authority, Scholars Choice Fund. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Clifton Henderson LLP

Greenwood Village, Colorado
August 28, 2002

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

This section of the Scholars Choice Fund's financial statements is a discussion and analysis of the financial performance of the Scholars Choice Fund (Fund) for the years ended June 30, 2002 and 2001. The Fund is an Internal Revenue Code (IRC) Section 529 college savings program. The Colorado Student Obligation Bond Authority (Authority), a division of the Department of Higher Education of the State of Colorado, administers the Fund, the Student Loan Programs Fund and the Prepaid Tuition Fund. The Fund is presented as a fiduciary fund (particularly a private purpose trust fund) in the State of Colorado Comprehensive Annual Financial Report. Management is responsible for the financial statements, footnotes and this discussion. The management's discussion and analysis should be read in conjunction with the Fund's financial statements.

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The new reporting Standards for fiduciary funds require a Statement of Fiduciary Net Assets and a Statement of Changes in Fiduciary Net Assets. This reporting is consistent with the Standards previously in existence and therefore the presentation of these financial statements is consistent with prior periods.

Overview of the Financial Statements:

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

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

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

Analysis of Financial Activities:

The Executive Director of the Department of Higher Education of the State of Colorado (Executive Director) and the Authority's Board of Directors approves the annual budget and the investment policy of the Fund. The Authority has entered into an agreement with Salomon Smith Barney, Inc. (SSB), a subsidiary of Citigroup Inc. to manage the Fund. The Fund offers five investment options in which participants may invest. These investment options are designed to help meet the investment goals of investors.

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

Comparison of Current Year Results to Prior Year:

Condensed Statement of Fiduciary Net Assets as of June 30,

	<u>2002</u>	<u>2001</u>
Cash and investments	\$ 528,676,171	\$ 71,091,562
Receivables	<u>9,391,578</u>	<u>1,159,689</u>
Total assets	538,067,749	72,251,251
Total liabilities	<u>5,336,577</u>	<u>641,488</u>
Total fiduciary net assets	\$ <u>532,731,172</u>	\$ <u>71,609,763</u>

Overall fiduciary net assets increased by over \$461.1 million during the fiscal year ending June 30, 2002. The Authority amended its agreement with SSB as of July 15, 2001 to add multi-share pricing, which helped increase sales of the Fund through financial professionals. In addition, a change to the federal tax treatment of college savings programs took effect January 1, 2002. These two changes are the primary reason for the significant increase in fiduciary net assets. Receivables and liabilities are comprised primarily of investment activities and increased due to the volume of assets.

Condensed Statement of Changes in Fiduciary Net Assets for the Years Ended June 30,

	<u>2002</u>	<u>2001</u>
Net investment income	\$ (38,029,501)	\$ (795,740)
Participant contributions	507,642,911	39,022,670
Reimbursement of operating expenses	<u>189,473</u>	<u>-</u>
Total additions	<u>469,802,883</u>	<u>38,226,930</u>
Benefits paid to participants and withdrawals	6,852,063	2,998,536
Administrative and service fees	1,639,938	307,734
Operating expenses	<u>189,473</u>	<u>-</u>
Total deductions	<u>8,681,474</u>	<u>3,306,270</u>
Net change in fiduciary net assets	461,121,409	34,920,660
Fiduciary net assets, beginning of year	<u>71,609,763</u>	<u>36,689,103</u>
Fiduciary net assets, end of year	\$ <u>532,731,172</u>	\$ <u>71,609,763</u>

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

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

Net investment income is comprised of dividends, interest income, and net realized and unrealized gains or losses from security transactions, net of investment fees. Net investment income decreased significantly due to two factors. Market conditions had the greatest impact on the Fund this year, with a fair market adjustment that reduced net assets during the year by \$44,218,596. Additionally, dividend and interest income of \$6,977,566 were lower as a percent of average net assets from a year ago. Investment fees of \$788,471 for 2002 doubled in amount from 2001 but as a percentage of average net assets were lower than the previous year. The change in investment fees was due in part to the new share classes offered.

Benefits paid to participants and withdrawals were larger in part due to the increase in participation in the Fund. As discussed above, the significant increase in net assets of the Fund came from the increase in participant contributions, which has had an impact on all categories within the Statement of Changes in Fiduciary Net Assets for the year ended June 30, 2002. The Internal Revenue Service issued regulations which allow investors to change their investment options within the Fund once each twelve months. These regulations also allow an investor to rollover his or her investment to another Section 529 plan one time each calendar year. Even with these changes, the percentage of benefits paid to participants and withdrawals was lower than last year by 2%.

Reimbursement of operating expenses of \$189,473 was due to an amendment to the agreement between the Authority and SSB. In prior years, the Authority was reimbursed 0.30% of average daily net assets of the Fund for operating expenses. As of July 15, 2001, the Authority was reimbursed 0.10% of average daily net assets of the Fund and 0.20% of average daily net assets directly from SSB. See Note 1 for a description of investment, service and administrative fees.

Administrative and service fees were consistent from last year to this year at 0.6% of average end of fiscal year net assets.

Economic Factors:

- ❖ Performance of individual participant accounts is dependent on risk factors associated with market-based investments. Refer to the Scholars Choice College Savings Program Disclosure Statement and Participation Agreement for a discussion of the various risk factors associated with the Fund.
- ❖ On January 1, 2002, the Economic Growth and Tax Relief Act of 2001 was signed into law. This law excludes from federal taxable income the earnings on any withdrawals that are used for qualified higher education expenses as defined in Section 529 of the Internal Revenue Code. This exclusion will automatically be repealed December 31, 2010, after which earnings on withdrawals will again be subject to federal income tax.

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

Requests for Information:

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

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2002 AND 2001**

	2002	2001
Fiduciary assets:		
Cash and cash equivalents	\$ 7,399	\$ 141,375
Investments, at fair value	528,668,772	70,950,187
Receivable for portfolio units sold	8,104,032	981,856
Dividends and interest receivable	1,098,073	177,833
Accounts receivable, other	<u>189,473</u>	<u>-</u>
Total fiduciary assets	538,067,749	72,251,251
 Liabilities:		
Due to custodian	527,327	-
Payable for investments purchased	4,351,143	606,603
Service and administration fees payable	268,634	34,885
Due to Student Loan Program Funds	<u>189,473</u>	<u>-</u>
Total liabilities	5,336,577	641,488
 Total fiduciary net assets, restricted	 <u>\$ 532,731,172</u>	 <u>\$ 71,609,763</u>

The accompanying notes are an integral part of these financial statements.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2002 AND 2001**

	2002	2001
Additions:		
Gross earnings on investments:		
Dividends	\$ 6,977,303	\$ 3,190,451
Interest	263	11,096
Net realized unrealized loss from security transactions	<u>(44,218,596)</u>	<u>(3,645,562)</u>
	(37,241,030)	(444,015)
Less investment fees	<u>(788,471)</u>	<u>(351,725)</u>
Net investment loss	(38,029,501)	(795,740)
Participant contributions	507,642,911	39,022,670
Reimbursement of operating expenses	<u>189,473</u>	<u>-</u>
Total additions	<u>469,802,883</u>	<u>38,226,930</u>
 Deductions:		
Benefits paid to participants and withdrawals	6,852,063	2,998,536
Service fees	1,355,009	154,374
Administrative fees	284,929	153,360
Operating expenses	<u>189,473</u>	<u>-</u>
Total deductions	<u>8,681,474</u>	<u>3,306,270</u>
Net change in fiduciary net assets	461,121,409	34,920,660
Fiduciary net assets, beginning of year	<u>71,609,763</u>	<u>36,689,103</u>
Fiduciary net assets, end of year	<u>\$532,731,172</u>	<u>\$ 71,609,763</u>

The accompanying notes are an integral part of these financial statements.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002 AND 2001**

1. Organization and Summary of Significant Accounting Policies:

Pursuant to Colorado Revised Statutes 23-3.1-2 and 23-3.1-3, as amended, the Colorado Student Obligation Bond Authority (Authority) became a division of the Colorado Department of Higher Education (Department) of the State of Colorado as of May 26, 2000. The Executive Director of the Department has responsibility for oversight and management of the Authority. In addition, the Authority has a nine-person Board of Directors (Board) designated by the Governor and approved by the State Senate to serve four-year terms.

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

Scholars Choice Fund

The Fund was established to provide families with an additional opportunity to save for future college education expenses. The Fund, which was formed during the 1999 legislative session, began operations on October 19, 1999. As a Section 529 plan under the Internal Revenue Code (IRC), the Fund offers certain federal and State tax advantages to investors. Prior to January 1, 2002, the primary tax advantages include tax deferral of investment earnings and distributions taxed at the student's tax rate if used for qualified higher education expenses. Effective January 1, 2002, the primary tax advantage to participants in the Fund is the ability to exclude from federal taxable income the earnings on any withdrawals that are used for qualified higher education expenses, as that term is defined in Section 529 of the IRC.

As the trustee for the Fund, the Authority has entered into an agreement with Salomon Smith Barney, Inc. (SSB), a subsidiary of Citigroup Inc., to manage the Fund. The investment return for the Fund is based on the market performance of investments selected by its manager. Participants may invest in one or more of the following options:

- **Age-Based Portfolios:** Contributions are invested in one of seven portfolios according to the age of the student. As the student gets older and closer to college years, the investment shifts from equity funds, which offer greater growth potential but increased volatility, to more stable bond and money market funds as follows:

Student's Age	Portfolio #	Equity Funds	Fixed Income	Money Market Funds
0-3 years	1	80%	20%	0%
4-6 years	2	70%	30%	0%
7-9 years	3	60%	40%	0%
10-12 years	4	50%	50%	0%
13-15 years	5	40%	50%	10%
16-18 years	6	20%	55%	25%
19+ years	7	10%	60%	30%

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2002 AND 2001**

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

Scholars Choice Fund (continued)

- **Balanced Portfolio:** Contributions are invested 50% in equity mutual funds and 50% in bond funds throughout the life of the investment (Portfolio #4). The Balanced Portfolio may be appropriate for account owners who wish to maintain a more consistent level of risk throughout the life of their investment.
- **Years to Enrollment Portfolios:** Contributions are invested in a series of portfolios that shift from equity mutual funds to bond and money market funds as the student approaches school years. This option may be suitable for adults planning to return to college or graduate school. These portfolios are identical to Portfolios 3 through 7 in the Age-based Portfolios.

Years to Enrollment	Portfolio #	Equity Funds	Fixed Income	Money Market Funds
10-12 years	3	60%	40%	0%
7-9 years	4	50%	50%	0%
4-6 years	5	40%	50%	10%
1-3 years	6	20%	55%	25%
Less than 1 year	7	10%	60%	30%

- **All Equity Portfolio:** Contributions are invested in equity mutual funds throughout the life of the account. Because of its focus on the equity markets, this option carries the highest return potential of the Scholars Choice options. It is only appropriate for account owners with longer time horizons who are comfortable with an increased level of risk while seeking higher long-term returns, or who use this option as part of an overall college savings strategy that includes less aggressive investments.
- **Fixed Income Portfolio:** Contributions are invested in bond funds throughout the life of the account. This option may be appropriate for account owners who are seeking the typically more stable returns of a fixed income investment, and who are willing to give up the long-term return potential that the stock market has historically offered. It may also be appropriate as part of an overall college savings strategy that includes more aggressive investments.

The Colorado Constitution and other State laws prohibit the State from providing its full faith and credit to obligations of entities such as the Fund. As a result, payments from the Fund are not guaranteed in any way by the State, and shall not be considered to have created a debt or obligation of the State. Such payments are limited obligations, payable from participants' individual accounts in the Fund, but not from the other assets of the Authority, or the State. Similarly, investments in the Fund are not insured by the Federal Deposit Insurance Corporation, or any other State or federal government agency. Investments in the Fund are not deposits or other obligations of Citigroup Inc. or any depository institution or SSB.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2002 AND 2001**

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

Reporting Entity:

The Fund was established to account for operations as a private-purpose trust, where both principal and earnings on principal may be spent for the trust's intended purpose. Participant contributions and the earnings thereon are invested to meet the obligations for future higher education expenses of a named student. The payment of general and administrative expenses and other activities of the Fund necessary to fulfill its purposes are recorded within the Fund. There are no other funds of the Authority combined in the accompanying financial statements. Thus, the accompanying financial statements are not intended to present the financial position, results of operations, and cash flows of the Authority as a whole in conformity with generally accepted accounting principles.

The Fund is comprised of nine active portfolios as of June 30, 2002. The accompanying financial statements report on the combined portfolios.

Basis of Accounting:

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles and standards of the Governmental Accounting Standards Board (GASB). The accrual basis of accounting is utilized by the Fund. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period they are incurred.

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

Investments and Revenue Recognition:

SSB has responsibility for investing the assets of each of the Fund's portfolios in equity mutual funds, fixed income mutual funds, money market funds, and other investments (Underlying Funds) in accordance with the Authority's Investment Policy Statement, and the Portfolio selected for investment by the participant.

Security transactions are accounted for on a trade date basis. Investments in the Underlying Funds are valued at the closing net asset value per share of each Underlying Fund on the day of valuation. Income distributions and short-term capital gain distributions from the Underlying Funds are recorded on the ex-dividend date as investment income and interest income is recorded on an accrual basis. Long-term capital gains, if any, from the Underlying Funds are recorded on the ex-dividend date as realized gains. Gains or losses on the sale of the Underlying Funds are calculated by using the specific identification method.

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

Participant Contributions:

The combined lifetime maximum amount of aggregate contribution for the Fund and all other Colorado Section 529 programs (including the Prepaid Tuition Fund, which also is offered by the Authority) for a particular student from all sources is \$235,000. The maximum lifetime contribution limit is set by the Authority based on Internal Revenue Service (IRS) guidelines and is subject to change. In particular, if the

COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2002 AND 2001

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

Participant Contributions (continued):

IRS adopts final regulations, they may require or permit a maximum contribution limit that differs from the \$235,000 contribution limit set under the Fund. In such event, participants may be required to reduce the contribution level by making non-qualified withdrawals, which could be subject to any applicable penalty and taxes.

Withdrawals:

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

Investment, Service and Administrative Fees:

The Authority has entered into a service agreement (Agreement) with SSB, as amended on July 15, 2001, pursuant to which SSB provides administrative, record keeping, marketing and investment management services to the Fund. According to the Agreement, each participant bears certain ongoing fees that will vary with the Unit Classes the participant chooses. These direct fees provide for the costs associated with distribution, servicing and administration of the Unit Classes. Such direct fees reduce the value of the participant's account as incurred. Such fees are payable to SSB monthly, solely from the assets of the Fund.

The Agreement states that the Authority will receive an administration fee at an annual rate of up to 0.10% of average daily net assets. These fees represent charges to the Scholars Choice Fund for actual administrative costs of the Authority. Such fees are payable to the Authority monthly, solely from the assets of the Fund.

Additionally, the Agreement states that the Authority will receive reimbursement of actual operating expenses up to 0.20% of the average daily net assets. Such fees are payable to the Authority monthly, solely from SSB. These expenses are recorded as operating expenses with a corresponding reimbursement of operating expenses for a net effect of zero to the Fund. Such operating expenses do not reduce participants' accounts.

Prior to the amendment to the Agreement, the Authority received an administration fee at an annual rate of up to 0.30% of average daily net assets. Such fees were payable to the Authority monthly, solely from the assets of the Fund.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2002 AND 2001**

2. Cash, Cash Equivalents and Investments:

Cash and Cash Equivalents:

As contributions are received from participants, SSB holds the cash in the Fund until such time as it may be invested in the Underlying Funds of the chosen investment Portfolios. Depending upon the timing of the cash receipts, there could be a few days delay between the actual receipt of cash and the investment made on behalf of the participant.

Investments:

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

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

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

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

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

At June 30, 2002 and 2001, all of the Fund's investments were uncategorized because they are not evidenced by securities that exist in physical or book entry form. With respect to these investments, the Fund is subject to market risk, which represents exposure to changes in the market, such as changes in interest rates or changes in the price or principal value of a security.

3. Units:

The beneficial interests of each participant and beneficiary in the net assets of the portfolios are represented by units. Contributions to and redemptions from the portfolios are subject to terms and limitations defined in the participation agreement between the participant and the Fund. Contributions (other than by electronic funds transfers) will purchase units in a portfolio at the net asset value per unit for that portfolio calculated on the business day following the day payment is received by SSB. Contributions by electronic funds transfers will purchase units at the unit value calculated on the day of transfer or, in certain cases, on the day that the funds become available. Withdrawals result in the redemption of units, based on the unit value next determined following SSB's receipt of the withdrawal request. Unit values for each portfolio are determined daily. There are no distributions of net investment gains or net investment income to the portfolios' participants or beneficiaries.

COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2002 AND 2001

4. Risk Management:

The Authority is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The Authority has retained these risks, except where it has determined that commercial insurance is more cost beneficial or legally required. The Colorado Governmental Immunity Act establishes limits for claims made against governmental entities. These limits are \$150,000 per injury or \$600,000 per occurrence. Claim expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated.

For the years ended June 30, 2002, and June 30, 2001, no claims have been brought against the Scholars Choice Fund.

5. Net Assets:

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

The Fund had restricted fiduciary net assets of \$532,731,172 and \$71,609,763 as of June 30, 2002 and 2001, respectively.

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

Members of the Legislative Audit Committee:

We have audited the financial statements of Colorado Student Obligation Bond Authority, Scholars Choice Fund, Department of Higher Education, State of Colorado as of and for the year ended June 30, 2002, and have issued our report thereon dated August 28, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Colorado Student Obligation Bond Authority, Scholars Choice Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Colorado Student Obligation Bond Authority, Scholars Choice Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

Clifton Henderson LLP

Greenwood Village, Colorado
August 28, 2002

SUPPLEMENTARY INFORMATION

Colorado Student Obligation Bond Authority
Scholars Choice Fund
Supplementary Schedule - Combining Statement of Fiduciary Net Assets
June 30, 2002

	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6	Portfolio 7	Fixed Income	Equity	Total
Fiduciary assets:										
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 7,399	\$ -	\$ -	\$ -	\$ 7,399
Investments, at fair value	58,018,881	46,484,124	56,539,257	136,781,341	45,574,915	25,812,028	8,187,664	12,501,795	138,768,767	528,668,772
Receivable for portfolio units sold	1,007,706	697,361	1,126,822	1,690,512	741,023	162,934	151,470	179,622	2,346,582	8,104,032
Dividends and interest receivable	105,575	107,018	134,731	353,880	102,653	60,873	10,288	51,217	171,838	1,098,073
Accounts receivable, other	22,452	17,382	20,353	51,092	14,858	8,336	2,609	3,417	48,974	189,473
Total fiduciary assets	<u>59,154,614</u>	<u>47,305,885</u>	<u>57,821,163</u>	<u>138,876,825</u>	<u>46,433,449</u>	<u>26,051,570</u>	<u>8,352,031</u>	<u>12,736,051</u>	<u>141,336,161</u>	<u>538,067,749</u>
Liabilities:										
Due to custodian	25,032	17,481	53,220	105,409	32,082	-	39,257	138,586	116,260	527,327
Payable for investments purchased	843,908	628,510	1,015,847	518,349	709,191	47,130	35,309	12,061	540,838	4,351,143
Service and administrative fees payable	26,901	22,599	27,233	68,578	23,522	13,152	4,403	5,715	76,531	268,634
Due to Student Loan Program Funds	22,452	17,382	20,353	51,092	14,858	8,336	2,609	3,417	48,974	189,473
Total liabilities	<u>918,293</u>	<u>685,972</u>	<u>1,116,653</u>	<u>743,428</u>	<u>779,653</u>	<u>68,618</u>	<u>81,578</u>	<u>159,779</u>	<u>782,603</u>	<u>5,336,577</u>
Total fiduciary net assets, restricted	<u>\$ 58,236,321</u>	<u>\$ 46,619,913</u>	<u>\$ 56,704,510</u>	<u>\$ 138,133,397</u>	<u>\$ 45,653,796</u>	<u>\$ 25,982,952</u>	<u>\$ 8,270,453</u>	<u>\$ 12,576,272</u>	<u>\$ 140,553,558</u>	<u>\$ 532,731,172</u>
Units Outstanding	<u>6,250,529</u>	<u>4,776,473</u>	<u>5,817,009</u>	<u>13,316,453</u>	<u>4,525,322</u>	<u>2,415,231</u>	<u>744,540</u>	<u>1,111,017</u>	<u>18,470,804</u>	
Unit Value	<u>\$ 9.32</u>	<u>\$ 9.76</u>	<u>\$ 9.75</u>	<u>\$ 10.37</u>	<u>\$ 10.09</u>	<u>\$ 10.76</u>	<u>\$ 11.11</u>	<u>\$ 11.32</u>	<u>\$ 7.61</u>	

See accompanying independent auditors' report.

Colorado Student Obligation Bond Authority
Scholars Choice Fund
Supplementary Schedule - Combining Statement of Changes in Fiduciary Net Assets
For the fiscal year ended June 30, 2002

	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6	Portfolio 7	Fixed Income	Equity	Total
Additions:										
Gross earnings on investments:										
Dividends	\$ 726,368	\$ 680,563	\$ 928,947	\$ 2,584,709	\$ 735,911	\$ 447,978	\$ 130,621	\$ 300,487	\$ 441,719	\$ 6,977,303
Interest	25	34	76	49	23	24	-	1	31	263
Net realized and unrealized loss from security transactions	(5,016,372)	(3,779,415)	(3,617,699)	(8,363,281)	(1,940,928)	(616,067)	(81,496)	52,590	(20,855,928)	(44,218,596)
	(4,289,979)	(3,098,818)	(2,688,676)	(5,778,523)	(1,204,994)	(168,065)	49,125	353,078	(20,414,178)	(37,241,030)
Less investment fees	(124,754)	(87,889)	(104,383)	(257,464)	(56,002)	(34,585)	(8,014)	(12,984)	(102,396)	(788,471)
Net investment income	(4,414,733)	(3,186,707)	(2,793,059)	(6,035,987)	(1,260,996)	(202,650)	41,111	340,094	(20,516,574)	(38,029,501)
Participant contributions	58,402,745	42,769,055	50,025,735	119,831,280	40,345,512	19,923,313	6,471,394	13,083,081	156,790,796	507,642,911
Reimbursement of operating expenses	22,452	17,382	20,353	51,092	14,858	8,336	2,609	3,417	48,974	189,473
Total additions	<u>54,010,464</u>	<u>39,599,730</u>	<u>47,253,029</u>	<u>113,846,385</u>	<u>39,099,374</u>	<u>19,728,999</u>	<u>6,515,114</u>	<u>13,426,592</u>	<u>136,323,196</u>	<u>469,802,883</u>
Deductions:										
Benefits paid to participants and withdrawals	366,081	226,611	620,700	1,843,875	262,406	485,942	670,321	859,055	1,517,072	6,852,063
Administrative fees	33,763	26,138	30,607	76,832	22,344	12,535	3,924	5,138	73,648	284,929
Service fees	137,948	115,069	133,106	348,745	111,951	61,624	21,557	24,406	400,603	1,355,009
Operating expenses	22,452	17,382	20,353	51,092	14,858	8,336	2,609	3,417	48,974	189,473
Total deductions	<u>560,244</u>	<u>385,200</u>	<u>804,766</u>	<u>2,320,544</u>	<u>411,559</u>	<u>568,437</u>	<u>698,411</u>	<u>892,016</u>	<u>2,040,297</u>	<u>8,681,474</u>
Portfolio exchanges, net	<u>(7,491,232)</u>	<u>(1,242,887)</u>	<u>53,064</u>	<u>1,737,233</u>	<u>1,672,605</u>	<u>3,588,897</u>	<u>1,493,611</u>	<u>(328,083)</u>	<u>516,792</u>	<u>-</u>
Net change in fiduciary net assets	<u>45,958,988</u>	<u>37,971,643</u>	<u>46,501,327</u>	<u>113,263,074</u>	<u>40,360,420</u>	<u>22,749,459</u>	<u>7,310,314</u>	<u>12,206,493</u>	<u>134,799,691</u>	<u>461,121,409</u>
Fiduciary net assets, beginning of year	<u>12,277,333</u>	<u>8,648,270</u>	<u>10,203,183</u>	<u>24,870,323</u>	<u>5,293,376</u>	<u>3,233,493</u>	<u>960,139</u>	<u>369,779</u>	<u>5,753,867</u>	<u>71,609,763</u>
Fiduciary net assets, end of year	<u>\$ 58,236,321</u>	<u>\$ 46,619,913</u>	<u>\$ 56,704,510</u>	<u>\$ 138,133,397</u>	<u>\$ 45,653,796</u>	<u>\$ 25,982,952</u>	<u>\$ 8,270,453</u>	<u>\$ 12,576,272</u>	<u>\$ 140,553,558</u>	<u>\$ 532,731,172</u>

See accompanying independent auditors' report.

Colorado Student Obligation Bond Authority
Scholars Choice Fund
Supplementary Schedule - Combining Schedule of Investments
June 30, 2002

	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5	Portfolio 6	Portfolio 7	Fixed Income	Equity	Total
Underlying funds:										
Smith Barney Investment Trust - Smith Barney										
Large Capitalization Growth Fund	\$ 14,309,890	\$ 11,468,618	\$ 11,237,458	\$ 27,323,135	\$ 6,771,256	\$ 2,581,976	\$ 415,823	\$ -	\$ 75,937,905	\$ 150,046,061
Salomon Brothers Investors Value Fund	14,513,122	11,630,696	11,321,705	27,075,617	6,882,869	2,573,574	404,043	-	48,584,590	122,986,216
Smith Barney Small Cap Core Fund, Inc.	8,767,292	4,688,987	5,703,620	6,936,491	2,305,768	-	-	-	14,246,272	42,648,430
The American Funds Group Euro Pacific Growth Fund	8,814,832	4,714,720	5,735,313	6,973,964	2,318,062	-	-	-	-	28,556,891
MFS Government Securities Fund	5,811,801	6,995,825	11,306,282	27,626,742	9,100,010	9,033,370	-	7,389,955	-	77,263,985
Smith Barney Investment Funds - Smith Barney										
Investment Grade Bond Fund	5,801,944	6,985,278	8,422,674	20,397,118	4,546,880	-	-	3,159,539	-	49,313,433
Smith Barney Funds, Inc. - Short-Term High Grade										
Bond Fund	-	-	2,812,205	20,448,274	9,100,047	5,160,702	4,909,859	1,952,301	-	44,383,388
Smith Barney Money Funds, Inc. - Cash Portfolio	-	-	-	-	4,550,023	6,462,406	2,457,939	-	-	13,470,368
Total investments, at fair value	<u>\$ 58,018,881</u>	<u>\$ 46,484,124</u>	<u>\$ 56,539,257</u>	<u>\$ #####</u>	<u>\$ 45,574,915</u>	<u>\$ 25,812,028</u>	<u>\$ 8,187,664</u>	<u>\$ 12,501,795</u>	<u>\$ #####</u>	<u>\$ 528,668,772</u>

See accompanying independent auditors' report.

**COLORADO STUDENT OBLIGATION BOND AUTHORITY
SCHOLARS CHOICE FUND
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SECTION 2-3-103 (2) states in part:

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

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

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