STATE OF COLORADO
Denver, Colorado

DEFERRED COMPENSATION PLAN
FINANCIAL STATEMENTS
June 30, 2001 and 2000

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Members of the Legislative Audit Committee:

This report contains the results of a financial audit of the Deferred Compensation Plan of the State of Colorado for the Fiscal Years ended June 30, 2001 and 2000. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our conclusions, findings and recommendations and the responses of the Department of Personnel.

Clifton Gunderson LLP

Denver, Colorado
November 8, 2001

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DEFERRED COMPENSATION PLAN
FINANCIAL AUDIT
Fiscal Year Ended June 30, 2001

Authority, Purpose, and Scope

This audit was conducted under Sections 2-3-103 and 24-52-102 (6), C.R.S., which authorize the State Auditor to conduct audits of all departments, institutions, and agencies of State government and the Plan. The State Auditor contracted with Clifton Gunderson LLP to perform this audit. We conducted the audit according to generally accepted auditing standards. The purpose of this report is to present the results of the financial audit of the Deferred Compensation Plan for the Fiscal Years ended June 30, 2001 and 2000, and to report on current year findings and on the implementation status of the prior year review recommendation.

Financial Audit Opinion

We found the State of Colorado Deferred Compensation Plan (the "Plan") financial statements to be fairly presented in all material respects for the Fiscal Year ended June 30, 2001. Our opinion letter, dated August 23, 2001, is presented in the financial statement section of this report.

Deferred Compensation Plan Purpose and Summary Activity

The Plan was established in 1981 to provide State employees and officials with a means of investing a portion of their State compensation on a tax-deferred basis. The Plan is governed by a nine-member Deferred Compensation Committee, and is administered by the Employee Benefits Unit within the Department of Personnel.

Statutory authority for the Plan and the State Deferred Compensation Committee (the "Committee") is contained in Sections 24-52-101 to 24-52-104, C.R.S. Colorado statutes also specify in which instruments participants may invest, which includes "any legitimate investment, including but not limited to investment programs of any bank, or savings and loan association, life insurance contracts, deferred annuities, equity products, governmental bonds, real estate investment trusts, or any other investment products."

The Governmental Accounting Standards Board (GASB) Statement 32, *Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans,* is the accounting guideline for the Plan. Deferred Compensation Plans are also governed by the requirements of Internal Revenue Code Section 457. The Code was amended during 2001. The new law will allow substantial change to the Plan effective beginning January 1, 2002 including:

- Increased contribution limits.
- Additional opportunity to "catch-up" contributions for participants who are age 50 and above.
- The ability to consolidate retirement accounts.
- More flexibility for withdrawals upon retiring or changing employers.

Beginning in Fiscal 1999, the assets and related income of the Plan may no longer be assets of the State and must be held in trust for the exclusive benefit of the participants and their beneficiaries.

The Plan utilizes a third party for administrative services that include recordkeeping, participant education and marketing. The administrative services are required to be re-bid every five years. Great-West/Benefits Corp was selected as the Plan's new third-party administrator effective July 1, 2000. Plan enhancements under the new administrator include reduced fees and asset allocations, transfers and account balance inquiry via the Internet.

Additional Required Disclosures

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. There were no adjustments arising from the audit that could, in our judgment, either individually or in the aggregate, have a significant effect on the entity's financial reporting process.

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

Summary of Findings and Recommendations

The Plan has two current year findings and recommendations. The first finding is a continuation and update of a prior year finding and relates to changes in the Plan that are needed due to changes in the Internal Revenue Code. The second finding is related to reconciliation procedures between the State's financial reporting system and the quarterly reports from its third party administrator. The Plan agrees with these recommendations. In addition, the findings from the Fiscal Year 2000 audit have been fully or partially implemented.

Rec. No.	Page No.	Recommendation Summary	Plan's Response	Implementation Date
1	7	Investigate and implement changes to Plan documents that would be favorable to employees.	Agreed	January 2002
2	8	Reconcile quarterly reports from Great West Life to the COFRS System.	Agreed	September 2001

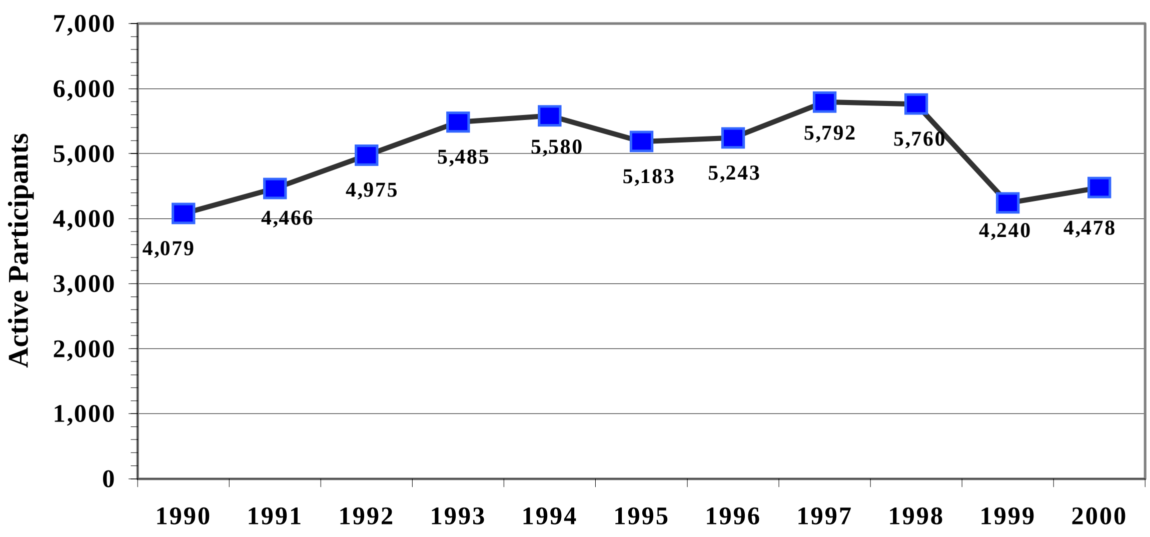
Deferred Compensation Plan

Description and Background

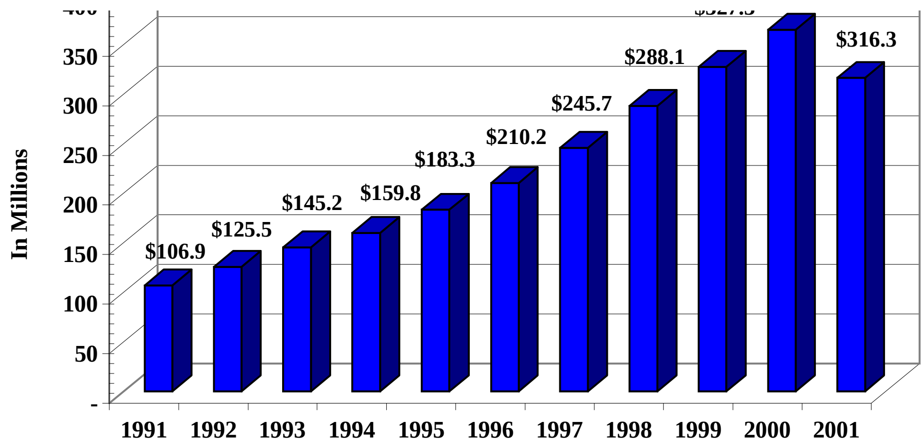
The Colorado Employees Deferred Compensation Plan was established in 1981 to provide State employees and officials with a means of investing a portion of their State compensation on a tax-deferred basis. The Plan is governed by a nine-member Deferred Compensation Committee, and is administered by the Employee Benefits Unit within the Department of Personnel. Statutory authority for the Deferred Compensation Plan and State Deferred Compensation Committee is contained in Sections 24-52-101 et. seq., C.R.S. Effective January 1, 2001, the State of Colorado (employer) offered a match allowed by PERA (HB 00-1225). The employer match is dollar-for-dollar up to 3% (State and School Divisions) of PERA includible salary to any employee contributing to a 457, 401(k) and/or 403(b) Plan on a monthly basis. The PERA Board of Trustees sets the employer match annually each September (SB 99-090). The match is conditioned on PERA's actuarially determined liability for benefits being fully funded.

Growth of the Plan

The number of State employees and officials who are actively contributing to the Deferred Compensation Plan has increased from 4,079 in calendar year 1990 to 4,478 in calendar year 2000. This represents an increase of 10 percent. Because the Plan has recognized some decline in active participants in recent years, the Plan has increased marketing efforts to attract new participants. A new system administrator was hired beginning July 1, 2000. Marketing services and enhanced customer service requirements are included with the system administrator contract. The following graph shows growth and decline in participants actively contributing to the Plan for calendar years 1990 through 2000.

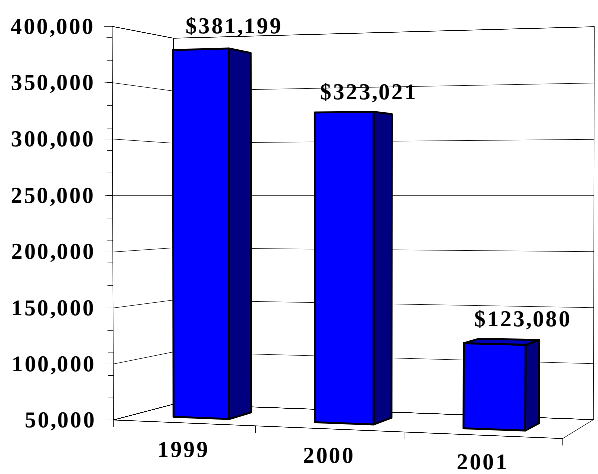


The Plan's total assets have increased steadily over the past several years, except for a downturn beginning during the fourth quarter of 2000. The Plan's assets have increased from about $107 million as of June 30, 1991, to about $317 million as of June 30, 2001. The total Plan assets at June 30, 2001 include approximately $2.7 million of assets attributable to the employer match which began in January 2001. The following graph shows the growth in the value of total assets, in millions, between Fiscal Years 1991 and 2001.



Reduced Asset Fee

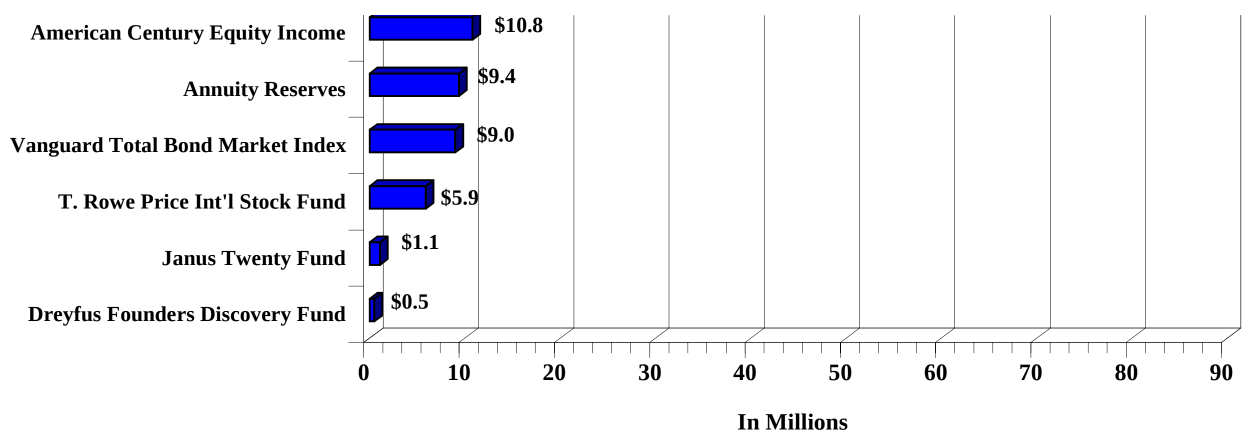
Since the Plan's inception, an asset fee has been charged to active participants to offset the expenses incurred in administering the Plan. As a result of the Plan's growth, the Deferred Compensation Committee has been able to reduce the fee at a consistent rate over the last several years. In January of 1985, under the prior third party administrator, the annual asset fee was 1.5 percent of each participant's balance subject to certain limitations. Since then, the fee has decreased to 0.17 in 1998 and remained at that percentage until June 30, 2000. This represents a decrease of 87 percent. In July 2000, the Plan changed the asset fee to a flat $18 per participant per year in order to compete comparatively with PERA's 401(k) Plan. Effective July 2000, for those participants new to the Plan, no fee is charged for the first year or until their balance reaches $1,800, as defined by 24-52-102(5)(a) CRS. The following graph illustrates the decrease in the fee recognized by the Plan from Fiscal Years 1999 to 2001.



The Plan's Committee continues to review the asset fee on an annual basis. The accountant for the Plan prepares a cost analysis based on current costs of the Plan and makes projections. Recommendations are made to the Committee who votes to adopt a new asset fee based on the analysis.

Plan Investment Options

The Plan offers participants the opportunity to invest in eleven different investment options from seven companies. The following table shows the distribution of invested Plan assets (as a percentage of total invested Plan assets of $316,268,756) by investment option as of June 30, 2001. Annuity reserves and Great West Guaranteed Certificates were not offered at June 30, 2001.



Findings and Recommendations

<u>The Plan Should Investigate and Implement Changes to the Plan Documents That Would be Favorable to Employees.</u>

The Deferred Compensation Plan contains a provision to allow participants to increase their maximum contribution when they are within three years of their normal retirement age. The State's Deferred Compensation Plan's definition of normal retirement age is the same as the definition outlined in the PERA retirement plan for an employee to receive an unreduced retirement benefit. This definition is based on a combination of age and years of service. For example, members are eligible for unreduced retirement benefits at age 50 with 30 years of service, age 55 with 25 years of service, age 60 with 20 years of service, or age 65 with 5 years of service. The amount of benefit depends on age and years of service.

This definition of normal retirement age has created a hardship on individuals who would like to take advantage of the "catch up provision" in the Deferred Compensation Plan, who are in fact close to their intended retirement, but may not be within three years of the definition of normal retirement as now contained in the Plan. An example is when individuals meet the age requirements, but intend to purchase years of service during their last year of retirement.

The IRS allows 457 Plans alternate ways to define "normal retirement age". The definition in the Plan document is generally controlling. A plan can use a set age, a formula, or a range of ages to define normal retirement age. However, the normal retirement age in the Plan document can be no later than age 70½.

One of the most important roles of the Committee is to ensure that the Plan document be as flexible as possible in assisting employees to maximize their retirement savings. Currently, one of the biggest advantages of the 457 Deferred Compensation Plan is the "catch-up provision" for eligible employees.

<u>Recommendation No.1</u>:

The Committee should investigate the possibility of changing the definition of "normal retirement age" in the Plan document in order to allow more employees to be eligible to take advantage of the "catch-up provisions" as outlined in IRC Section 457 and in the Plan document.

<u>Agency Response</u>:

Agree. The Committee agrees to review the definition of normal retirement age as defined in the Plan document and under the Treasury Regulations, 1.457-2(f)(4) as it relates to the "catch-up provision". The Plan documents are also being updated for both the 457 and 401(a) Plans in light of the Economic Growth and Tax Relief Act of 2001. As part of the discussion on the revisions to the Plan documents and the committee's ongoing Strategic Planning discussions, a review of "normal retirement age" will be included.

Reconciliation of Quarterly Reports from Great West Life to the State's Accounting System

The Deferred Compensation Plan changed its Plan administrator to Great West Life ("GWL") effective July 1, 2000. GWL provides various quarterly reports to the Plan which reflect the Plan activity including contributions, earnings, market value changes, and deductions. Some of these reports are used to record the Plan activity to the State's accounting system, however, there is no reconciliation procedure to agree the data from the reports generated from the State's accounting system to the quarterly reports provided by GWL.

By not performing an independent reconciliation of the GWL reports to the accounting system, errors in reporting may occur and not be detected. Such reconciliations are an important internal control that should be used by management to ensure that all activity of the Plan is properly recorded in the accounting records and to help identify errors.

The Plan should also continue to request both summary and detailed reports from GWL for this purpose. To be effective, the reconciliations need to be performed timely, reconciling items need to be investigated and adjustments need to be made to accounting records where necessary on a timely basis. Management should also review such reconciliations to ensure their completion. Timely and thorough reconciliations will help safeguard the Plan assets and will result in more accurate financial reporting for the Plan.

Recommendation No. 2:

We recommend that all accounts used to record the Plan activity as provided from Great West Life be reconciled quarterly to the GWL reports and the accounting system and reconciling items be investigated.

Agency Response:

Agree. The Department of Personnel has procedures in place for reconciling these reports. Although we have followed these guidelines during Fiscal Year 2001 and prior years, we will evaluate the efficiency and effectiveness of the current procedures for future quarters effective with the September 2001 quarterly reconciliation.

Disposition of Prior Year Audit Findings

Recommendation:

The Deferred Compensation Committee should investigate the possibility of changing the definition of “normal retirement age” in the Plan document in order to allow more employees to be eligible to take advantage of the “catch-up provisions” as outlined in IRC Section 457 and in the Plan document.

Fiscal Year – 2001 Disposition

Partially implemented. The Plan documents are being updated due to the changes included in the Economic Growth and Tax Relief Act of 2001. A review of “normal retirement age” will be addressed when updating the Plan documents. See current year recommendation No. 1.

Recommendation:

Now that the Plan has changed its procedures for accounting for asset fees in conjunction with a new third-party administrator beginning July 1, 2000, we recommend going forward that the asset fees be accounted for on the same basis for the Plan Asset Fund and the Administrative Fund. In addition to the same basis of recognition, the revenues and expenses should be recognized in the quarter when they are actually earned and incurred by the Plan.

Fiscal Year – 2001 Disposition

Implemented. At the June 2000 meeting, the Committee voted to reduce the State’s fee that is charged to participants to administer the Plan. The previous fee charged to participant’s accounts was .17% per year or .0425% per quarter times the value of assets. The new annual fee is now a flat $18 per year or $4.50 per quarter and will be recorded as revenue and expense in the same quarter under the same basis of recognition. This change eliminated the differences in the dollar amounts and the quarters to which they were applied which had occurred in previous years.

Independent Auditor's Report

Members of the Legislative Audit Committee

We have audited the Expendable Trust Funds balance sheets of the State of Colorado Deferred Compensation Plan as of June 30, 2001 and 2000, and the statements of revenues, expenditures, and changes in fund balance for the years ended June 30, 2001 and 2000. These financial statements are the responsibility of the Deferred Compensation Committee of the State of Colorado Deferred Compensation Plan. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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 the Summary of Significant Accounting Policies, the financial statements of the Deferred Compensation Plan of the State of Colorado are intended to present the financial position, and the results of operation and the changes in fund balance for only that portion of the financial reporting entity of the State of Colorado that is attributable to the transactions of the Deferred Compensation Plan.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Expendable Trust Funds as of June 30, 2001 and 2000, of the State of Colorado Deferred Compensation Plan and the revenues, expenditures and changes in fund balance of the Expendable Trust Funds of the State of Colorado Deferred Compensation Plan for the years ended June 30, 2001 and 2000, 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 23, 2001, on our consideration of the Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Clifton Gunderson LLP

Denver, Colorado
August 23, 2001

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
BALANCE SHEET
June 30, 2001

	Fiduciary Fund Type		
	Expendable Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non-appropriated)	Totals (Memorandum Only) 2001
ASSETS			
Cash in bank and with State Treasurer	$ 488,793	$ -	$ 488,793
Plan assets	-	316,268,756	316,268,756
TOTAL ASSETS	$ 488,793	$ 316,268,756	$ 316,757,549
LIABILITIES			
Vouchers payable and accrued liabilities	$ 44,964	$ -	$ 44,964
Compensated absences - annual and sick leave	6,318	-	6,318
TOTAL LIABILITIES	51,282	-	51,282
FUND BALANCE			
Unreserved - undesignated	437,511	-	437,511
Reserved	-	316,268,756	316,268,756
TOTAL FUND BALANCE	437,511	316,268,756	316,706,267
TOTAL LIABILITIES AND FUND BALANCE	$ 488,793	$ 316,268,756	$ 316,757,549

The accompanying summary of significant accounting policies and notes
are an integral part of the financial statements.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
BALANCE SHEET
June 30, 2000

	Fiduciary Fund Type		
	Expendable Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non-appropriated)	Totals (Memorandum Only) 2000
ASSETS			
Cash in bank and with State Treasurer	$ 379,045	$ 701,964	$ 1,081,009
Accounts receivable	114,690	-	114,690
Plan assets	-	364,174,675	364,174,675
TOTAL ASSETS	$ 493,735	$ 364,876,639	$ 365,370,374
LIABILITIES			
Vouchers payable and accrued liabilities	$ 77,510	$ -	$ 77,510
Compensated absences - annual and sick leave	11,189	-	11,189
TOTAL LIABILITIES	88,699	-	88,699
FUND BALANCE			
Unreserved - undesignated	405,036	-	405,036
Reserved	-	364,876,639	364,876,639
TOTAL FUND BALANCE	405,036	364,876,639	365,281,675
TOTAL LIABILITIES AND FUND BALANCE	$ 493,735	$ 364,876,639	$ 365,370,374

The accompanying summary of significant accounting policies and notes are an integral part of the financial statements.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
EXPENDABLE TRUST FUND
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
Year Ended June 30, 2001

	Fiduciary Fund Type		
	Expendable Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non-appropriated)	Totals (Memorandum Only) 2001
REVENUES			
Asset fees	$ 123,080	$ -	$ 123,080
Interest income	32,436	20,000,408	20,032,844
Administrative reimbursement fee	160,000	-	160,000
Investment gain/(loss)	-	(65,533,560)	(65,533,560)
Participant payroll deferrals	-	12,272,541	12,272,541
Employer match	-	2,723,465	2,723,465
Other revenue	41,025	-	41,025
Total revenues	356,541	(30,537,146)	(30,180,605)
EXPENDITURES			
Personal services	175,874	-	175,874
Workers compensation	929	-	929
Operating expenses	40,033	-	40,033
Indirect cost assessment	14,197	-	14,197
Administration and communication	65,675	-	65,675
Leased space	6,748	-	6,748
Legal services	20,610	-	20,610
Asset fees	-	123,080	123,080
Participant withdrawals	-	17,947,657	17,947,657
Total expenditures	324,066	18,070,737	18,394,803
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	32,475	(48,607,883)	(48,575,408)
FUND BALANCE, JULY 1	405,036	364,876,639	365,281,675
FUND BALANCE, JUNE 30	$ 437,511	$ 316,268,756	$ 316,706,267

The accompanying summary of significant accounting policies and notes are an integral part of the financial statements.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
EXPENDABLE TRUST FUND
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
Year Ended June 30, 2000

	Fiduciary Fund Type		
	Expendable Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non-appropriated)	Totals (Memorandum Only) 2000
REVENUES			
Asset fees	$ 323,021	$ -	$ 323,021
12B-1 fees	395,245	-	395,245
Interest income	20,574	17,503,870	17,524,444
Fund reimbursements	29,109	-	29,109
Investment gain/(loss)	-	24,425,236	24,425,236
Participant payroll deferrals	-	12,445,585	12,445,585
Total revenues	767,949	54,374,691	55,142,640
EXPENDITURES			
Personal services	181,491	-	181,491
Workers compensation	3,596	-	3,596
Operating expenses	21,539	-	21,539
Indirect cost assessment	15,023	-	15,023
Administration and communication	439,991	-	439,991
Leased space	5,317	-	5,317
Legal services	11,137	-	11,137
Asset fees	-	425,930	425,930
Participant withdrawals	-	16,323,402	16,323,402
Total expenditures	678,094	16,749,332	17,427,426
EXCESS OF REVENUES OVER EXPENDITURES	89,855	37,625,359	37,715,214
FUND BALANCE, JULY 1	315,181	327,251,280	327,566,461
FUND BALANCE, JUNE 30	$ 405,036	$ 364,876,639	$365,281,675

The accompanying summary of significant accounting policies and notes are an integral part of the financial statements.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2001 and 2000

The accompanying financial statements reflect the financial activities of the State of Colorado Deferred Compensation 457 Plan ("the Plan") and are in conformance with generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) Statement 32, *Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans*, is the accounting guideline for the Plan.

Internal Revenue Code (IRC) Section 457 was amended as of August 20, 1996. Existing plans were required to be in compliance with new requirements by January 1, 1999 under the new requirements. The assets and related income of the Plan are no longer assets of the State and are to be held in trust for the exclusive benefit of the participants and their beneficiaries. In order to be in compliance with the revised provisions of the Code, the Deferred Compensation Committee (the “Committee”) amended the Plan document effective July 1, 1998, to state that all assets are to be held in trust for the exclusive benefit of the participants and their beneficiaries.

REPORTING ENTITY

The Plan is included within the State of Colorado for reporting purposes and in conformance with the guidelines established by GASB concerning financial accountability. The Plan is available to eligible employees as a supplement to their basic retirement plan. The Plan's financial activities are presented consistently with the presentation of statewide financial activities. These activities are reported according to generally accepted accounting principles for governmental organizations.

Enabling legislation, 24-52-102(1)(b) of the Colorado Revised Statutes (C.R.S.), created a committee who "shall establish rules and regulations for the administration of this article and for the transaction of its business." Further, the Committee is given authority to "exercise its powers and to perform its duties and functions under a type 1 transfer as defined by the "Administrative Organization Act of 1968, "article 1 of this title." (24-52-102(1)(c)(I) C.R.S.) In 1998, legislation was passed to create the trust in which the assets of the Plan reside, appoint the Committee as trustees to the 457 Plan, and identify the assets as for the exclusive use of the participants and their beneficiaries.

Under the State of Colorado Deferred Compensation Plan, State employees are eligible to voluntarily contribute a portion of their compensation to the Plan. By definition, an "Employee" means any person including elected officials employed by and receiving compensation from the State of Colorado. Under the Plan, employees may elect to defer a portion of their salary and defer paying state and federal income taxes on the deferred portion until the withdrawal date. The deferred compensation amount is not available for withdrawal by employees until termination, death, or unforeseeable emergency.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2001 and 2000

Effective January 1, 2001, the State of Colorado (employer) offered a match allowed by PERA (HB 00-1225). The employer match is dollar-for-dollar up to 3% (State and School Divisions) of PERA includible salary to any employee contributing to a 457, 401(k) and/or 403(b) Plan on a monthly basis. The PERA Board of Trustees sets the employer match annually each September (SB 99-090). The match is conditioned on PERA's actuarially determined liability for benefits being fully funded.

The State has no liability for losses under the Plan but does have the duty of due care required of an ordinary prudent investor. The total amount of the employer's contribution for the year ended June 30, 2001 was $2,723,465.

The Internal Revenue Service has determined that the provisions of the Plan are in compliance with IRC Section 457.

FUND STRUCTURE

The Plan's administrative operations are recorded in an expendable trust fund. Expenditures are controlled according to Committee direction. Annually, the budget is subject to legislative appropriation by the Colorado General Assembly.

Recording revenues and expenditures is one of the characteristics of an expendable trust fund. This reflects more detail of the Plan's activity as it relates to investment income, fees, withdrawals and transfers and payroll deposits.

BASIS OF ACCOUNTING

The expendable trust fund activity is reported on the modified accrual basis of accounting. This basis of accounting recognizes revenues when they are both measurable and available to finance current operations or to liquidate liabilities existing at Fiscal Year-end. Revenues susceptible to accrual include administrative fees and interest revenue. Expenditures are recorded when the related fund liability is incurred.

Assets of the Plan, which include employee payroll deferrals and the related earnings, are held by the investment companies in the State's name and are recorded at fair value in accordance with the provisions of the IRC Section 457.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2001 and 2000

MEMORANDUM ONLY - TOTAL COLUMN

Total columns on the financial statements are captioned "Memorandum Only" only to facilitate financial analysis. Data in these columns do not present financial position, results of operations or changes in financial position. Interfund eliminations have not been made in the aggregation of this data.

STATE OF COLORADO
DEFERRED COMPENSATION PLAN
NOTES TO FINANCIAL STATEMENTS
June 30, 2001 and 2000

NOTE 1 - INVESTMENTS – TRUST FUND ASSETS AND PROPERTY AND RIGHTS HELD UNDER DEFERRED COMPENSATION PLAN

At June 30, 2001 and 2000, the Deferred Compensation Plan Trust Fund assets are recorded within the expendable trust fund described above at fair value.

C.R.S. 24-52-103(1) specifies which instruments participants may invest which includes "any legitimate investment, including but not limited to, investment programs of any bank, or savings and loan association, life insurance contracts, deferred annuities, equity products, governmental bonds, real estate investment trusts, or any other investment products."

The investments include purchased annuity contracts from Great West Life Assurance Company which are depicted at their contract value of $9,383,415 and $10,334,610, as of June 30, 2001 and 2000, respectively. The contract value represents the sum of periodic cash payments to be made to an annuitant over a contractual period of time.

In order to consolidate the low risk funds offered by the Plan, the 60-month and 84-month certificates previously offered by Great-West Life, as well as the Money Market offered by Vanguard, were discontinued as of January 1, 2001. As a result, Great-West Life dropped the transfer limitation on the Stable Value Fund, allowing this fund to be 100% portable. Also, as a result of the 2000 annual fund review by an outside consultant, the Plan dropped Fidelity Puritan and T. Rowe Price New America Growth due to poor performance. Effective January 1, 2001, the Plan offered two replacement funds, Dreyfus Premier Balanced and American Century Equity Income Funds, as well as adding small-cap and large-cap growth funds, Dreyfus Founders Discovery and Janus Twenty, to the asset classes.

NOTE 2 - ADMINISTRATIVE COMPONENT

Cash recorded in the administration expendable trust fund at June 30, 2001, and June 30, 2000, is on deposit with the State Treasurer. Detailed information on the State Treasurer's pooled cash and investments and the related risk categories is available from that office and in the State's Comprehensive Annual Financial Report.

Due to a change in accounting procedures, the interfund receivable normally recorded for the administrative asset fees charged by the Plan on participants' accounts is not reflected as of June 30, 2001 and 2000. Previously, revenues for asset fees were recognized in the Administrative Fund one quarter prior to the related expenditure recognized in the Plan Asset Fund generating the interfund receivable. The change in procedures now recognizes the same fees in the same quarter in both funds. The change resulted in recognizing four quarters of

NOTE 2 - ADMINISTRATIVE COMPONENT (CONTINUED)

expenditures and three quarters of revenues for asset fees for the year ended June 30, 2000. This difference of approximately $100,000 of asset fee expenditures over revenues for the year ended June 30, 2000 represents one quarter of asset fees recognized as revenue in prior years over expenditures.

Due to a change in the third party administrator, the Plan recognized fees collected and reported in the same quarter in both funds for the year ended June 30, 2001.

Accrued compensated absences are recognized and recorded as personal service expenses. The corresponding liability represents an unpaid obligation for vested annual and sick leave of the State's employees who work for the Plan.

Within the expendable trust fund, the fund balance represents accumulated excess of revenues collected less expenditures. Per Section 24-52-102(5), C.R.S., any asset fee collected in excess of expenditures shall be used to reduce participants' annual fees in the following year. Accordingly, the Committee periodically reviews the fee to assess and adjust the rate to meet this statutory requirement. In July 2000, the Committee implemented a new fee structure for the Plan lowering the fees from .17 percent of the participant’s balance to $18 per participant per year (excluding those participants in payout). This is a $4.50 quarterly deduction from each participant’s account balance. This fee is only deducted from participants with an account balance of at least $1,800, as defined by 24-52-102(5)(a)CRS.

As noted above, the Plan’s administrative operations are recorded in the expendable trust fund. Revenues are collected from an assessment on each Plan participant's investment balance as of the end of each calendar quarter, which is known as an asset fee. This fee is set by the Plan's Committee and may not exceed 1.0 percent of the participant's assets in the Plan (Section 24-52-102(5), C.R.S.). Such revenues are deposited with the State Treasurer in a restricted interest bearing cash account.

The indirect cost assessment reflects the Plan's share of the Department's administrative and other overhead charges.

Administration and communication includes several components such as marketing costs to attract and enroll new participants, communication, and recordkeeping services. The Committee contracts with an independent contractor to perform basic administration and recordkeeping services. Employee contributions are remitted to a bank depository from which the contractor transmits the contributions to the various investment providers for investment in participant directed funds. The third party administrator maintains all records detailing employee contributions, related earnings, account balances, and fees for individual participants.

NOTE 2 - ADMINISTRATIVE COMPONENT (CONTINUED)

Different arrangements were negotiated during Fiscal Year 2000 by the Committee with some of the investment companies in reducing their administrative costs such as recordkeeping and statement production which results in additional revenue to the Plan. This additional revenue allows the Committee to charge an even lower fee to the participants. The fees due at quarter ending June 30, 2000, are reflected in the Administration Fund as an accounts receivable of $114,690. Due to the change in third party administrator in July 2000 and the structure of the Plan, this fee was no longer recognized during the year ended June 30, 2001.

NOTE 3 – OTHER PENSION PLANS

Plan Description

Virtually all of the State's employees participate in a Defined Benefit Pension Plan. The purpose of the Defined Benefit Pension Plan is to provide income to members and their families at retirement or in case of death or disability. This Plan is a cost-sharing multiple-employer deferred benefit plan administered by the Public Employees Retirement Association (PERA). PERA was established by State statute in 1931. Responsibility for the organization and administration of the Plan is placed with the Board of Trustees of PERA. Changes to the Plan require legislation by the General Assembly. The State Plan, as well as the other division's plans, are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203.

Plan members vest after five years of service and most are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service, or at age 65 with 5 years of service. Members are also eligible for retirement benefits without a reduction for early retirement if they are at least 55 and have a minimum of 5 years of service credit and their age plus years of service equals 80 or more. State troopers and judges comprise a small percentage of Plan members but have higher contribution rates and are eligible for retirement benefits at different ages and years of service. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

Members disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their spouse or their eligible children under the age of 18 (23 if a full time student) are entitled to monthly benefit payments. If there is no eligible spouse, financially dependent parents will receive a survivor's benefit.

NOTE 3 – OTHER PENSION PLANS (CONTINUED)

Funding Policy

Most employees contribute 8.0 percent (10.0 percent for State troopers) of their gross covered wages to an individual account in the Plan. During Fiscal Year 2000 – 2001, the State contributed 10.4 percent (13.1 percent for State troopers and 14.0 percent for the Judicial Branch) of the employee's gross covered wages which was allocated by PERA before January 1, 2001, as follows:

- 1.1 percent was allocated to the Health Care Trust Fund.
- 9.3 percent was allocated to the defined benefit plan.

After January 1, 2001, the State contribution was allocated to three separate programs by PERA according to a statutory change in funding policy:

- 1.42 percent was allocated to the Health Care Trust Fund.
- The amount needed to meet the match requirements established by the PERA Board was allocated to the Matchmaker program (See Note 4 below.)
- The balance remaining after allocations to the Matchmaker program and the Health Care Trust Fund was allocated to the defined benefit plan.

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

The plan's contributions to the three programs described above for the Fiscal Years ending June 30, 2001, 2000, and 1999 were $1,175, $1,330, and $859, respectively. These contributions met the required contributions for each year.

NOTE 4 – VOLUNTARY TAX-DEFERRED RETIREMENT PLANS

Beginning on January 1, 2001, the Matchmaker Program established a State match for PERA member's voluntary contributions to tax-deferred retirement plans. The match was 100 percent of up to 3 percent of the employee's gross covered wages paid during the month (7 percent for judges in the Judicial Branch). The PERA Board sets the level of the match annually – based on the actuarial funding of the defined benefit pension plan. Two percent of gross salary plus fifty

NOTE 4 – VOLUNTARY TAX-DEFERRED RETIREMENT PLANS (CONTINUED)

percent of any reduction in the overall contribution rate due to overfunding of the pension plan was available for the match. PERA offers a voluntary 401(k) plan entirely separate from the defined benefit pension plan. The State offers a 457 Deferred Compensation Plan and certain agencies and institutions of the State offer a 403(b) Plan. Members who contribute to any of these plans also receive the State match.

NOTE 5 - POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

Health Care Program

The PERA Health Care Program began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During Fiscal Year 2000 - 2001, the premium subsidy was $115 for those with 20 years of service credit ($230 for members under age 65), and it was reduced by 5 percent for each year of service fewer under 20. Medicare eligibility also affects the premium subsidy.

The Health Care Trust Fund is maintained by a contribution as discussed in Note 3.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility, and the number of years of retiree service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured plans and with health maintenance organizations to provide services within Colorado. As of December 31, 1999, there were 31,266 participants, including spouses and dependents, from all contributors to the Plan.

Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential and Rocky Mountain Life. Members may join one or both plans, and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

NOTE 5 - POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS (CONTINUED)

Other Programs

Separate post-retirement health care and life insurance benefit plans exist in some State colleges and universities but are small in comparison to the PERA plan for State employees. The State has no liability for any of these post-retirement health care and life insurance plans.

NOTE 6 - 2000 PRESENTATION

Certain reclassifications have been made to the 2000 amounts to conform to the 2001 presentation.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

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

Members of the Legislative Audit Committee

We have audited the financial statements of the State of Colorado Deferred Compensation Plan as of and for the year ended June 30, 2001, and have issued our report thereon dated August 23, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the State of Colorado Deferred Compensation Plan'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*. We also noted certain immaterial instances of noncompliance that we have reported to members of the Legislative Audit Committee in this report.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Colorado Deferred Compensation Plan'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 is not intended to be and should not be used by anyone other than this specified party. However, this report is a matter of public record and its distribution is not limited.

Clifton Gunderson LLP

Denver, Colorado
August 23, 2001

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DEFERRED COMPENSATION PLAN
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