

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
AUDITED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED JUNE 30, 2004 & 2003**

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*Terry & Stephenson, P.C.*  
**Contract Auditors**

Members of the Legislative Audit Committee:

This report contains the results of a financial and compliance audit of the Deferred Compensation Plan of the State of Colorado for the Fiscal Years ended June 30, 2004 and 2003. The audit was conducted pursuant to Section 24-52-102(6), C.R.S., which authorizes the State Auditor to conduct audits of the Deferred Compensation Plan. The report presents our findings, conclusions, and recommendations and the responses of the Department of Personnel & Administration.

*Terry & Stephenson, P.C.*

Denver, Colorado  
September 2, 2004

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**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
FINANCIAL AUDIT REPORT SUMMARY  
YEAR ENDED JUNE 30, 2004**

**Authority, Purpose, and Scope**

This audit was conducted under Sections 24-52-102(6), C.R.S., which authorizes the State Auditor to audit the Deferred Compensation Plan. Terry & Stephenson, P.C. conducted this audit under contract with the State Auditor. The audit was performed in accordance with auditing standards generally accepted in the United States of America. The purpose of this report is to present the results of the financial audit of the Deferred Compensation Plan for the Fiscal Year ended June 30, 2004, and to report on current year findings and on the implementation status of the prior year recommendations.

**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, 2004. Our opinion letter, dated September 2, 2004, is presented in the financial section of the 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.

Colorado statutes specify in which instruments a participant 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 other investment products."

The Governmental Accounting Standards Board (GASB) Statement No. 32, *Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans*, establishes accounting and financial reporting standards for the Plan. Deferred Compensation Plans are also governed by the requirements of Internal Revenue Code Section 457. In July 2003, the Internal Revenue Service (IRS) issued final regulations relating to deferred compensation plans of state and local governments. The regulations provide guidance on:

- Annual deferrals, deferral limits and deferral agreements.
- Timing of distributions.
- Taxation of distributions.
- Disqualification of eligible plans.
- Miscellaneous provisions.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
FINANCIAL AUDIT REPORT SUMMARY  
YEAR ENDED JUNE 30, 2004**

**Deferred Compensation Plan Purpose and Summary Activity (Continued)**

The assets and related income of the Plan are not 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/Benefit Corporation. was selected as the Plan's third-party administrator beginning June 1, 2000 through June 30, 2001, with up to four additional one-year renewal terms. The contract has been renewed for three consecutive one-year terms through June 30, 2004.

**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.

*Audit Adjustment*

Two audit adjustments totaling \$967,733 were recorded to the Plan's financial statements. The adjustments were necessary to record a \$956,397 reduction in plan deductions due to participant loans, and to record \$11,336 of interest income earned on participant loans.

*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 Plan's financial statements or our report on those financial statements.

**Summary of Findings and Recommendations**

There is one current year finding and recommendation related to the recording of the participant loan receivable and related interest income.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
RECOMMENATION LOCATOR  
YEAR ENDED JUNE 30, 2004**

<u>Rec. No.</u>	<u>Page No.</u>	<u>Recommendation Summary</u>	<u>Plan's Response</u>	<u>Implementation Date</u>
1	8	Record participant loan receivables and corresponding interest	Agree	September 2004

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
DESCRIPTION OF PLAN  
YEAR ENDED JUNE 30, 2004**

**Description and Background**

The State of Colorado 457 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. The composition of the Committee is specified under Section 24-52-102(1)(a)(I)(B), C.R.S. as:

- The State Treasurer, or designee.
- The State Controller, or designee.
- Four employees who are participants in the Plan, one of whom may be a retiree who is a participant in the plan, elected by participants (SB04-107)
- One participant in the Public Officials' and Employees' Defined Contribution Plan, appointed by the Governor (SB02-231).
- One Senator or former Senator, who is a participant in the Plan, appointed by the President of the Senate.
- One Representative or former Representative, who is a participant in the Plan, appointed by the Speaker of the House of Representatives.

The Committee is staffed by the Employee Benefits Unit within the Department of Personnel and Administration. Statutory authority for the Deferred Compensation Plan and State Deferred Compensation Committee is referenced in Sections 24-52-101 to 24-52-105, C.R.S. The plan added a 401(a) Defined Contribution Match Plan in January 2001 to accept the employer match made possible by the Public Employees' Retirement Association (PERA). The employer match was suspended effective with May 2004 payroll due to legislation (SB04-132). The Deferred Compensation Committee assumed the fiduciary responsibility of the Public Officials' and Employees' Defined Contribution Plan effective July 1, 2002 (SB 02-231).

In January 2004, the 457 Plan implemented a loan program. Participants may request one loan each from the 457 Plan and the 401a Match Plan.

**Growth of the Plan**

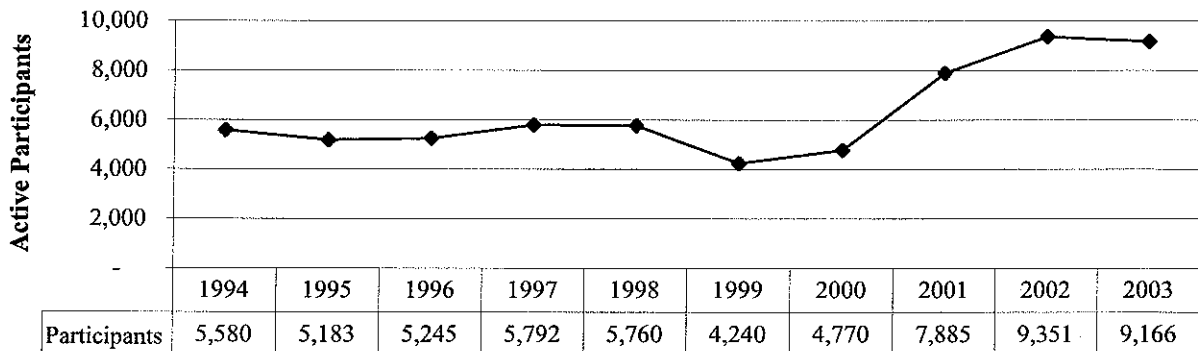
The following graph shows growth and decline in active participants for calendar years 1994 through 2003. Participation steadily increased over calendar years 2001 through 2002 as a result of legislation that allowed the State to offer an employer match to those employees contributing to a supplemental retirement plan, such as the 457 Plans. Additionally, the marketing efforts of Great-West regarding the employer match and the advantage to the Plan since the passage of the Economic Growth Tax Relief & Reconciliation Act of 2001 (EGTRRA) (which provided increased portability among 457, 401(k), and 403(b) plans) has increased participation in the Plan. The decrease in participation in 1999 was a result of legislation that reduced the normal retirement age to 50 with 30 years of service. Hence, many participants took advantage of this change and retired in calendar year 1999.



**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
DESCRIPTION OF PLAN  
YEAR ENDED JUNE 30, 2004**

**Growth of the Plan (Continued)**

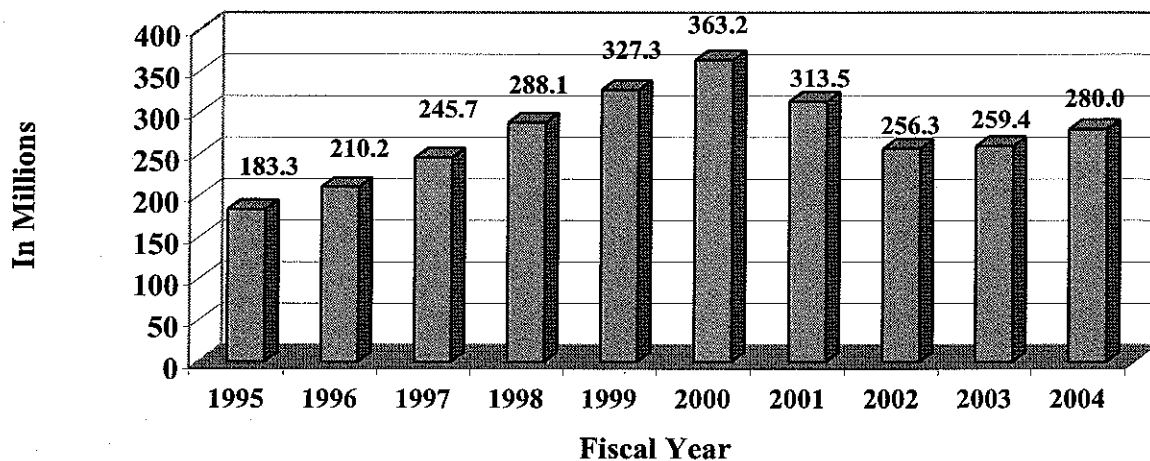
**PLAN PARTICIPANTS**



Source: 1994-1999 Security First Group, 2000-2003 Great-West Retirement Services

The Plan's assets have decreased from a high of \$363.2 million as of June 30, 2000, to \$280 million as of June 30, 2004 due to the increase in participants' use of plan assets to purchase years of service, reduction of early retirement age and therefore early retirement by plan participants. The following graph shows the change in the value of total assets, in millions, from June 30, 1995 through June 30, 2004.

**PLAN ASSETS**



Source: 1995-1999 Security First Group, 2000-2004 Great-West Benefit Corporation

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
DESCRIPTION OF PLAN  
YEAR ENDED JUNE 30, 2004**

**Asset Fee**

In July 2002, the asset fee was reduced to \$9 per participant per year, with no fee charged to new participants for the first year and thereafter until the balance reached \$900, in compliance with the one percent limitation in accordance with Section 24-52-102(5)(a), C.R.S. The \$9 asset fee has continued through Fiscal Year 2003 and Fiscal Year 2004.

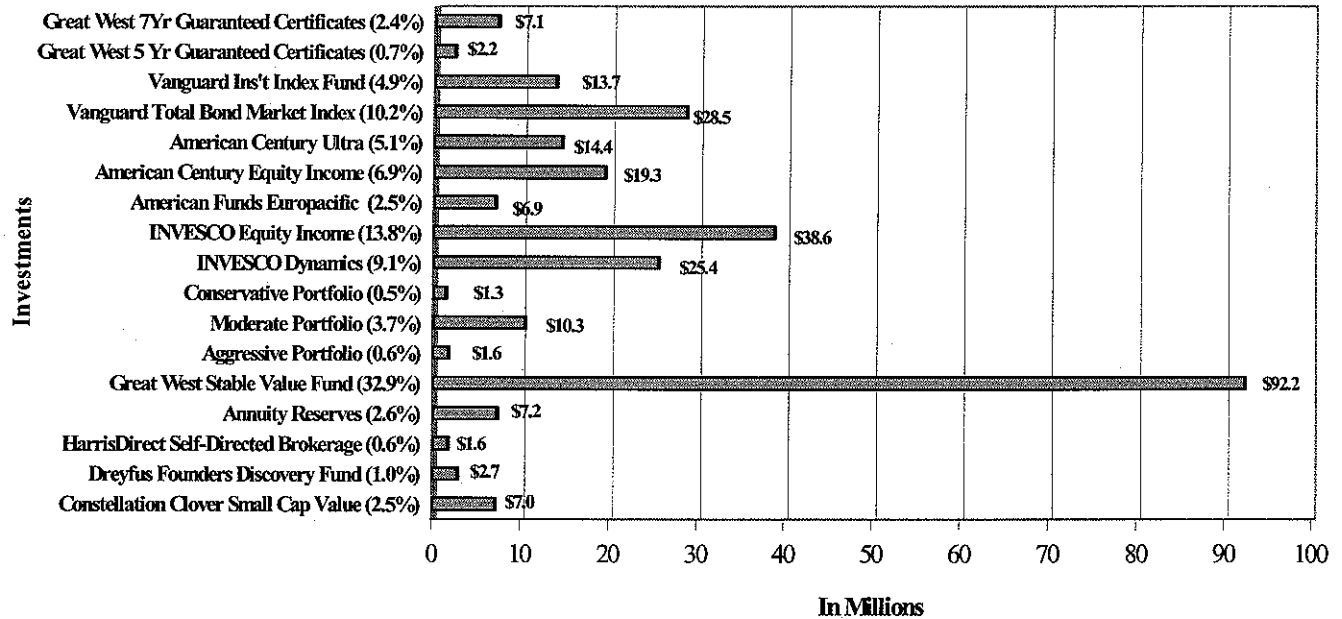
The Plan's administrative income from the fee for the year ending June 30, 2004 and 2003, was \$432,698 and \$457,898, respectively. The Plan's Committee continues to review the asset fee on an annual basis. Commencing in 2002, the investment consultant for the Plan in conjunction with the staff accountant, annually prepares a cost analysis based on current costs of the Plan and makes projections for future years. Recommendations are made to the Committee, which then reviews and discusses them at a monthly Committee meeting. The Committee then votes whether to adopt a new asset fee based on the analysis.

**Plan Investment Options**

The Plan offers participants the opportunity to invest in fourteen different investment options from eight companies. Three additional options that are closed to new investments include: Great West 7-year Guaranteed Certificates, Annuity Reserves, and Great West 5-year Guaranteed Certificates. The Plan began offering portfolio funds (Conservative, Moderate and Aggressive) as of January 2003. These funds are a mix of the core funds in the Plan as recommended by the Investment Consultant. The following table shows the distribution of invested Plan assets (as a percentage of total invested Plan assets of \$279,671,614) by investment options as of June 30, 2004. The table below excludes cash held in the Plan Asset Fund for payouts to participants in the subsequent month and cash with the State Treasurer in the Administrative Fund for Plan expenses.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
DESCRIPTION OF PLAN  
YEAR ENDED JUNE 30, 2004**

**Distribution of Plan Assets**



The chart above lists the INVESCO funds as part of the fund offerings through June 30, 2004. The 457 Deferred Compensation Committee decided to terminate the INVESCO Equity Income funds at the May 13, 2004 monthly meeting. At the June 17, 2004 Deferred Compensation Meeting, the Committee decided to replace INVESCO Dynamics with Artisan Midcap and replace INVESCO Equity Income with Washington Mutual Fund A. The new funds were in place as of August 25, 2004 and therefore will be reflected in the Fiscal Year 2005 audit report.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
FINDINGS AND RECOMMENDATIONS  
YEAR ENDED JUNE 30, 2004**

**Participant Loan Receivable**

Effective January 5, 2004, the State of Colorado Deferred Compensation Plan began offering loans to participants enrolled in the 457 and 401a Match Plans. The Participant Loans Receivable balance and earned interest is not properly reflected as a part of the Plan Assets in COFRS. The loans and related interest were recorded as a plan deduction. Instead, loans and interest should be recorded as a reduction to the Long Term Investment and an increase to Participant Loans Receivable. As the loans are repaid and interest is earned, a reduction to Participant Loans Receivable and an increase to the Long Term Investment and Interest Exempt should be recorded. Loans in the amount of \$967,933 and earned interest in the amount of \$11,336 have been recorded in the attached financial statements.

**Recommendation 1:**

The Department of Personnel and Administration should properly record participant loans and related interest earned in the Deferred Compensation Fund on a regular basis.

**Response 1:**

Agree. The Department will set-up and begin recording loans in COFRS for the quarter ending September 30, 2004.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
DISPOSITION OF PRIOR YEAR AUDIT RECOMMENDATIONS  
YEAR ENDED JUNE 30, 2004**

The following recommendations are from the audit for Fiscal Year 2003.

**Recommendation (1):**

Obtain the appropriate Determination Letter from the IRS.

**Fiscal Year 2004 Disposition (1):**

Implemented. The Deferred Compensation Committee received the IRS Determination Letter dated December 31, 2003 for the 401(a) Defined Contribution Match Plan.

**Recommendation (2):**

Record the asset fee revenue on the accrual basis in both funds.

**Fiscal Year 2004 Disposition (2):**

Implemented. The Department of Personnel and Administration implemented this effective with quarter ending September 2003.

**Independent Auditors' Report**

Members of the Legislative Audit Committee:

We have audited the Pension Trust Fund statement of fiduciary net assets of the Colorado Deferred Compensation Plan as of June 30, 2004 and 2003, and the statements of changes in fiduciary net assets for the years ended June 30, 2004 and 2003. 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 net assets and the changes in net assets 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 net assets available of the Pension Trust Fund as of June 30, 2004 and 2003, of the State of Colorado Deferred Compensation Plan and the changes in net assets available of the Pension Trust Fund of the State of Colorado Deferred Compensation Plan for the years ended June 30, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The combining financial statements on page 24 and 25 are presented for the purpose of additional analysis and are not a required part of the financial statements of the Deferred Compensation Plan. These combining financial statements are also the responsibility of the Deferred Compensation Committee of the State of Colorado Deferred Compensation Plan. Such additional information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the financial statements taken as a whole.

In accordance with *Governmental Auditing Standards*, we have also issued our report dated September 2, 2004, 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.

The management's discussion and analysis on pages 12-14 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Denver, Colorado  
September 2, 2004

*Jerry + Stephenson P.C.*

**STATE OF COLORADO  
DEPARTMENT OF PERSONNEL & ADMINISTRATION  
DEFERRED COMPENSATION PLAN  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2004**

This analysis of the Deferred Compensation Plan's financial performance is intended to provide an overview of the financial activities of the Plan for the fiscal year ended June 30, 2004. Please read it in conjunction with the Description of the Plan on pages 4-7 and the financial statements, which begin on page 15.

The Plan is governed by a nine-member Deferred Compensation Committee, and is administered by the Employee Benefits Unit within the Department of Personnel & Administration.

The Employee Benefits Unit administers two funds related to the Deferred Compensation Plan: the Deferred Compensation Plan Fund and the Deferred Compensation Administration Fund, which is appropriated annually.

**Overview of the Financial Statements.** The discussion and analysis is intended to serve as an introduction to the financial statements of the Deferred Compensation Plan. The financial section of this report is comprised of two components: (1) fund financial statements, and (2) notes to the financial statements.

**Fund Financial Statements.** There are two financial statements presented for fiduciary funds. The Statements of Fiduciary Net Assets as of June 30, 2004 and 2003, indicates the net assets available to pay future payments and gives a snapshot at a particular point in time. The Statement of Changes in Fiduciary Net Assets for the year ended June 30, 2004 and 2003, provides a view of the current year's additions and deductions to the Plan.

**Notes to the financial statements.** The notes provide additional information that is essential for a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 17-23 of this report.

**Financial Highlights**

While the world equity market began to stabilize, plan assets for the Deferred Compensation Plan increased by \$20.2 million or 8%. The Plan experienced a \$20.7 million investment gain and an increase in interest income of \$0.7 million or 9% for the same reason as noted above.

Participant withdrawals increased by \$2.3 million or 5% over the previous year primarily due to passage of the Economic Growth Tax Relief & Reconciliation Act of 2001 (EGTRRA), which allows plan participants to use the amounts invested in the Plan to purchase PERA Service Credits. In addition, the cost to purchase PERA service credits increased in November 2003, which also contributed to participant withdrawals prior to that time.

Participant and employer contributions increased by \$4.1 million or 11% due primarily to the continuation of an aggressive marketing campaign directed at the higher education institutions. This increased awareness of the Plan and the increase in the contribution limits to \$13,000 per plan participant were the primary influences on the increased contributions.



**STATE OF COLORADO**  
**DEPARTMENT OF PERSONNEL & ADMINISTRATION**  
**DEFERRED COMPENSATION PLAN**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**YEAR ENDED JUNE 30, 2004**

<b>Deferred Compensation Administration Fund Net Assets</b>			
	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>% Change</u>
<b>Assets</b>			
Plan Assets	\$ 259,424,928	\$ 279,671,614	8%
Other Assets	875,283	1,934,649	121%
<b>Total Assets</b>	<u>260,300,211</u>	<u>281,606,263</u>	<u>8%</u>
<b>Liabilities</b>			
Vouchers Payable and Accrued Liabilities	46,339	93,839	103%
Compensated Absences - Annual and Sick Leave	5,069	3,793	-25%
<b>Total Liabilities</b>	<u>51,408</u>	<u>97,632</u>	<u>90%</u>
<b>Net Assets</b>			
Held in trust for pension benefits and other purposes	260,248,803	281,508,631	8%
<b>Total Net Assets</b>	<u>\$ 260,248,803</u>	<u>\$ 281,508,631</u>	<u>8%</u>

<b>Deferred Compensation Administration Fund Changes in Net Assets</b>			
	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>% Change</u>
<b>Additions</b>			
Interest Income	\$ 7,278,377	\$ 7,951,971	9%
Contribution:			
Employer	8,762,286	7,649,828	-13%
Participant	27,575,359	32,805,487	19%
Investment Gain/(Loss)	(4,127,171)	20,684,970	601%
Other Additions	413,786	424,012	2%
<b>Total Additions</b>	<u>39,902,637</u>	<u>69,516,268</u>	<u>74%</u>
<b>Deductions</b>			
Operations	424,296	487,433	15%
Participant Withdrawals	45,481,590	47,769,007	5%
<b>Total Deductions</b>	<u>45,905,886</u>	<u>48,256,440</u>	<u>5%</u>
<b>Changes In Net Assets</b>	<u>\$ (6,003,249)</u>	<u>\$ 21,259,828</u>	<u>454%</u>

**STATE OF COLORADO  
DEPARTMENT OF PERSONNEL & ADMINISTRATION  
DEFERRED COMPENSATION PLAN  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2004**

Below is a comparison of the Fiscal Year 2004 Budget to Actual Operation Deductions:

**Comparison of Fiscal Year 2004  
Budget to Actual Deductions**

	Budget	Actual	Over (Under)
Personal Services	\$ 227,703	\$ 171,837	\$ (55,866)
Workers Compensation	3,862	3,862	-
Operating Expenses	18,972	17,696	(1,276)
Administration and Communication	182,977	181,740	(1,237)
Leased Space	8,753	8,753	-
Legal Services	3,401	3,401	-
<b>Total Deductions</b>	<b>\$ 445,668</b>	<b>\$ 387,289</b>	<b>\$ (58,379)</b>

STATE OF COLORADO  
 DEFERRED COMPENSATION PLAN  
 STATEMENT OF FIDUCIARY NET ASSETS  
 JUNE 30,

	<u>2004</u>	<u>2003</u>
	<u>Pension Trust Fund</u>	<u>Pension Trust Fund</u>
<b>ASSETS</b>		
Cash in bank and with State Treasurer	\$ 901,256	\$ 819,769
Accounts receivable	1,033,319	55,160
Prepaid expenses	74	354
Plan assets	<u>279,671,614</u>	<u>259,424,928</u>
Total assets	<u>281,606,263</u>	<u>260,300,211</u>
<b>LIABILITIES</b>		
Vouchers Payable and accrued liabilities	93,839	46,339
Compensated absences- annual leave and sick leave	<u>3,793</u>	<u>5,069</u>
Total liabilities	<u>97,632</u>	<u>51,408</u>
<b>NET ASSETS</b>		
Held in trust for pension benefits and other purposes	<u>281,508,631</u>	<u>260,248,803</u>
Total net assets	<u>\$ 281,508,631</u>	<u>\$ 260,248,803</u>

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

STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS  
YEAR ENDED JUNE 30,

	2004	2003
	<u>Pension Trust Fund</u>	<u>Pension Trust Fund</u>
<b>ADDITIONS</b>		
Asset fees	\$ 93,994	\$ 119,126
Interest income	7,951,971	7,278,377
Administrative reimbursement fee	160,282	160,302
Contribution:		
Employer	7,649,828	8,762,286
Participant payroll deferral	32,805,487	27,575,359
Net investment gain/(loss)	20,684,970	(4,127,171)
Other revenue	169,736	134,358
Total additions	<u>69,516,268</u>	<u>39,902,637</u>
<b>DEDUCTIONS</b>		
Personal services	171,837	178,030
Workers compensation	3,862	3,273
Operating expenses	17,696	22,111
Indirect cost assessment	-	37,658
Administration and communication	181,740	76,341
Leased space	8,753	6,697
Legal services	3,401	3,349
Assets fees	100,144	96,837
Participant withdrawals	47,769,007	45,481,590
Total deductions	<u>48,256,440</u>	<u>45,905,886</u>
Change in net assets	21,259,828	(6,003,249)
<b>Net assets, beginning of year</b>	<u>260,248,803</u>	<u>266,252,052</u>
<b>Net assets, end of year</b>	<u>\$ 281,508,631</u>	<u>\$ 260,248,803</u>

The accompanying summary of significant accounting policies  
and notes are a part of the financial statements

**STATE OF COLORADO**  
**DEFERRED COMPENSATION PLAN**  
**NOTES TO FINANCIAL STATEMENT**  
**YEAR ENDED JUNE 30, 2004**

**NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements reflect the financial activities of the State of Colorado Deferred Compensation Plan ("the Plan") and are in conformance with generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) Statement No. 32, *Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans*, is the accounting guideline for the Plan.

**Reporting Entity**

The Plan is included within the State of Colorado's Comprehensive Annual Financial Report (CAFR) 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, Section 24-52-102(1)(b) of the Colorado Revised Statutes (C.R.S.), created a Committee which "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" (Section 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 trustee to the Plan, and identify the assets 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 distribution date. The deferred compensation amount is not available for distribution to employees until age seventy and one-half (70½), termination of employment, death, or unforeseeable emergency.

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(CONTIUNED)**

Effective January 1, 2001, the State of Colorado (employer) offered a match allowed by Public Employees' Retirement Association (PERA) (House Bill 00-1225). The employer match was a monthly dollar-for dollar match on PERA includible salary to any employee contributing to a 457, 401(k) and/or 403(b) plan (State and School Divisions). The PERA Board of Trustees sets the employer match annually each September (Senate Bill 99-090). The match for calendar year 2004 through May 31, 2004 was 1%. The employer match was suspended effective with May 2004 payroll due to legislation (SB04-132). 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 the Committee has the duty of standard of care as referenced in Section 24-52-102(1)(d)(I), C.R.S. The total amount of the employer's contribution for the year ended June 30, 2004 and 2003 was \$7,649,828 and \$8,762,286, respectively, under the match program.

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

**Fund Structure**

All investment activity as well as the Plan's administrative operations are recorded in a Pension Trust Fund. Expenditures are controlled according to Committee direction. Annually, the administrative budget is subject to legislative appropriation by the Colorado General Assembly.

**Basis of Accounting**

The Pension Trust Fund activity is reported on the accrual basis of accounting.

Assets of the Plan, which include employee payroll deferral 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 IRC Section 457.

**NOTE 2- INVESTMENTS- TRUST FUND ASSETS AND PROPERTY AND  
RIGHTS HELD UNDER DEFERRED COMPENSATION PLAN**

Section 24-52-103 (1), C.R.S. specifies which instruments participants may invest in 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 other investment products."

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 2- INVESTMENTS- TRUST FUND ASSETS AND PROPERTY AND RIGHTS  
HELD UNDER DEFERRED COMPENSATION PLAN (CONTINUED)**

The investments include purchased annuity contracts from Great West Life Assurance Company, which are recorded at their contract value of \$7,146,472 and \$7,769,449 as of June 30, 2004 and 2003, respectively. The contract value represents the sum of periodic cash payments to be made to an annuitant over a contractual period of time. All other Deferred Compensation Plan Trust Fund assets of \$272,525,142 and \$251,655,479 are recorded within the Pension Trust Fund at fair value at June 30, 2004 and 2003, respectively.

**NOTE 3- ADMINISTRATIVE COMPONENT**

Cash recorded in the Administration Pension Trust Fund at June 30, 2004 and 2003 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.

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.

The Plan's administrative operations are recorded in the Pension 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, and credited to the fund along with any investment earnings.

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. Effective July 1, 2002, the fee is \$9 per participant per year (excluding those participants in payout). This is a \$2.25 quarterly deduction from each participant's account balance. The fee is only deducted from participants with an account balance of at least \$900 to comply with the 1 percent limitation as defined by Section 24-52-102(5)(a), C.R.S.

According to the third-party administrator contract, which began July 1, 2000, the Plan is to receive an additional payment for each quarter in which the Contractor's earnings are in excess of 0.22 percent of Plan assets. The first additional payment from Great-West was due December 31, 2000 for the quarter ended September 30, 2000. Great-West earned in excess of the 0.22 percent of the Plan assets in each subsequent quarter, owing

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 3- ADMINISTRATIVE COMPONENT (CONTINUED)**

a proportionate share to the State. These additional payments totaled \$134,361 and \$154,432 for Fiscal Years 2003 and 2004, respectively.

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 record keeping services. The Committee contracts with a third party administrator to perform basic administration and record keeping services. Employee contributions are remitted to a bank depository from which the contractor transmits the contributions to the various investment providers for investment in the specific funds as designated by participants. The third party administrator maintains all records detailing employee contributions, related earnings, account balances, and fees for individual participants.

**NOTE 4- OTHER PENSION PLANS**

**Plan Description**

Virtually all of the department/institution's employees participate in a defined benefit pension plan. The plan's purpose is to provide income to members and their families at retirement or in case of death or disability. The plan is a cost sharing multiple employer plan administered by the Public Employees' Retirement Association (PERA). PERA was established by state statute in 1931. Responsibility for the organization and administration of the plan is placed with the Board of Trustees of PERA. Changes to the plan require legislation by the General Assembly. The state plan and other divisions' plans are included in PERA's financial statements, which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203, or by calling PERA at 303-832-9550 or 1-800-729-PERA (7372), or by visiting [www.copera.org](http://www.copera.org).

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



**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 4- OTHER PENSION PLANS (CONTINUED)**

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

**Funding Policy**

Most employees contribute 8.0 percent (10.0 percent for state troopers) of their gross covered wages to an individual account in the plan. During FY2004, the state contributed 10.15 percent of the employee's gross covered wages. Effective January 1, 2003, 1.10 percent of the total contribution was allocated to the Health Care Trust Fund through May 31, 2004, the amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker program (See Note 5 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, 2004, 2003, and 2002 were \$7,223, \$1,339, and \$1,717 respectively. These contributions met the contribution requirement for each year.

**NOTE 5- VOLUNTARY TAX-DEFERRED RETIREMENT PLANS**

Beginning on January 1, 2001, the Matchmaker Program established a state match for PERA member's voluntary contributions to tax-deferred retirement plans. For calendar years 2001 and 2002, the match was 100 percent of up to three percent of the employee's gross covered wages paid during the month. For calendar year 2003, the match was 100 percent of up to two percent of employee's gross covered wages paid during the month. For calendar year 2004 through May 31, 2004, the match was 100 percent of up to one percent of employee's gross covered wages paid during the month. The PERA Board sets the level of the match with two percent of gross salary plus 50 percent of any reduction in the overall contribution rate due to over funding of the pension plan available for the match. While the plan was not over funded in the current year, the maximum one-year change in the match rate is statutorily limited to one percent, and therefore, the match changed from two percent to one percent on January 1, 2004. Legislation passed in the 2004 session of the General Assembly terminated the match for pay periods ending after May 31, 2004. The match will

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 5- VOLUNTARY TAX-DEFERRED RETIREMENT PLANS (CONTINUED)**

resume when the actuarial value of the defined benefit plan assets are 110 percent of actuarially accrued plan liabilities.

PERA offers a voluntary 401k plan entirely separate from the defined benefit pension plan. The state offers a 457 deferred compensation plan and certain agencies and institutions of the state offer a 403b plan. Members who contribute to any of these plans also receive the state match.

**NOTE 6- POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE  
BENEFITS**

**Health Care Program**

PERACare (formerly known as the PERA Health Care Program) began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the Program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During Fiscal Year 2004, the premium subsidy was \$115.00 for those with 20 years of service credit (\$230.00 for members under age 65 and not eligible for Medicare), and it was reduced by 5 percent for each year of service fewer than 20.

The Health Care Trust Fund is maintained by an employer's contribution as discussed above in Note 4.

Monthly premium costs for participants depend on the health care plan selected, the number of persons covered, Medicare eligibility, and the number of years of service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured medical and prescription benefit plans, and with several health maintenance organizations providing services within Colorado. As of December 31, 2003, there were 37,067 enrollees in the plan.

**Life Insurance Program**

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

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
NOTES TO FINANCIAL STATEMENT  
YEAR ENDED JUNE 30, 2004**

**NOTE 6- 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 7- 457 LOAN PROGRAM**

On January 5, 2004, the State of Colorado Deferred Compensation Committee implemented a loan program for the 457/401a Match Plan participants. Participants are allowed a maximum of one loan per Plan at any given time. There are two types of loans available: General Purpose with a duration of one to five (1-5) years or, Principal Residence with a duration of one to fifteen (1-15) years. Refinancing an existing loan is not permitted. A minimum account balance of \$2,000 is required to apply for a loan. The minimum loan amount available to participants is \$1,000. The maximum amount available in aggregate for all plans is \$50,000 or 50% of the vested account balance whichever is less. The vested account balance remaining after a loan disbursement may not be reduced below the amount of outstanding loan balance at any time by withdrawal or distribution, including hardship withdrawals.

A \$50 origination fee shall be charged for each requested loan. An additional annual maintenance fee of \$25 (\$6.25 per quarter) will be deducted quarterly from the participant's account balance. The interest rate for loans is fixed at one percent (1%) over the Prime Rate published in the Wall Street Journal. The interest rate is subject to change by the 457 Committee, however; the rate may not exceed twelve percent (12%) at any given time. Loan payments shall be made through payroll deduction on a monthly basis.

As of June 30, 2004, \$967,733 in loans and corresponding interest receivable were outstanding, consisting of 307 participant loans.

As of June 30, 2004, there were four late loans recorded. These loans were subsequently paid and therefore not considered in default status. Participants are notified of a default at the end of the calendar quarter in which a missed payment occurs. The participant must make missed payments by the end of the calendar quarter after the quarter of the missed payments. If payments are still not made, the loan will be in default and considered a "deemed distribution", at which time the outstanding balance and any missed payments are reported to the IRS as income. The participant will receive a 1099R for the year in which the loan default occurs.

# **SUPPLEMENTARY INFORMATION**

STATE OF COLORADO  
 DEFERRED COMPENSATION PLAN  
 COMBINING STATEMENT OF FIDUCIARY NET ASSETS  
 JUNE 30, 2004

	Fiduciary Fund Type		
	Pension Trust Funds		Total
	Administration (Appropriated)	Deferred Compensation Plan (Non-appropriated)	
<b>ASSETS</b>			
Cash in bank and with State Treasurer	\$ 896,894	\$ 4,362	\$ 901,256
Accounts receivable	65,586	967,733	1,033,319
Prepaid expenses	74	-	74
Plan assets	-	279,671,614	279,671,614
	962,554	280,643,709	281,606,263
<b>Liabilities</b>			
Vouchers payable and accrued liabilities	89,477	4,362	93,839
Compensated absences- annual leave and sick leave	3,793	-	3,793
	93,270	4,362	97,632
<b>Net Assets</b>			
Held in trust for pension benefits and other purposes	869,284	280,639,347	281,508,631
Total net assets	\$ 869,284	\$ 280,639,347	\$ 281,508,631

STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSET  
YEAR ENDED JUNE 30, 2004

	<b>Pension Trust Funds</b>		<b>Total</b>
	<b>Administration (Appropriated)</b>	<b>Deferred Compensation Plan (Non-appropriated)</b>	
<b>ADDITIONS</b>			
Asset fees	\$ 93,994	\$ -	\$ 93,994
Interest income	28,868	7,923,103	7,951,971
Administrative reimbursement fee	160,282	-	160,282
Contribution:			-
Employer	-	7,649,828	7,649,828
Participant payroll deferral	-	32,805,487	32,805,487
Net investment gain/(loss)	(20,182)	20,705,152	20,684,970
Other revenue	169,736	-	169,736
<b>Total additions</b>	<b>432,698</b>	<b>69,083,570</b>	<b>69,516,268</b>
<b>DEDUCTIONS</b>			
Personal services	171,837	-	171,837
Workers compensation	3,862	-	3,862
Operating expenses	17,696	-	17,696
Administration and communication	181,740	-	181,740
Leased space	8,753	-	8,753
Legal services	3,401	-	3,401
Asset fees	-	100,144	100,144
Participant withdrawals	-	47,769,007	47,769,007
<b>Total deductions</b>	<b>387,289</b>	<b>47,869,151</b>	<b>48,256,440</b>
Change in net assets	45,409	21,214,419	21,259,828
<b>Net assets, beginning of year</b>	<b>823,872</b>	<b>259,424,931</b>	<b>260,248,803</b>
<b>Net assets, end of year</b>	<b>\$ 869,281</b>	<b>\$ 280,639,350</b>	<b>\$ 281,508,631</b>

STATE OF COLORADO  
 DEFERRED COMPENSATION PLAN  
 COMBINING STATEMENT OF FIDUCIARY NET ASSETS  
 JUNE 30, 2003

	<u>Fiduciary Fund Type</u>		
	<u>Pension Trust Funds</u>		<u>Total</u>
	<u>Administration (Appropriated)</u>	<u>Deferred Compensation Plan (Non-appropriated)</u>	
<b>ASSETS</b>			
Cash in bank and with State Treasurer	\$ 814,791	\$ 4,978	\$ 819,769
Accounts receivable	55,160	-	55,160
Prepaid expenses	354	-	354
Plan assets	-	259,424,928	259,424,928
	<u>870,305</u>	<u>259,429,906</u>	<u>260,300,211</u>
<b>Liabilities</b>			
Vouchers payable and accrued liabilities	41,361	4,978	46,339
Compensated absences- annual leave and sick leave	5,069	-	5,069
	<u>46,430</u>	<u>4,978</u>	<u>51,408</u>
<b>Net Assets</b>			
Held in trust for pension benefits and other purposes	823,875	259,424,928	260,248,803
Total net assets	<u>\$ 823,875</u>	<u>\$ 259,424,928</u>	<u>\$ 260,248,803</u>

STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSET  
YEAR ENDED JUNE 30, 2003

	<b>Pension Trust Funds</b>		<b>Total</b>
	<b>Administration (Appropriated)</b>	<b>Deferred Compensation Plan (Non-appropriated)</b>	
<b>ADDITIONS</b>			
Asset fees	\$ 119,126	\$ -	\$ 119,126
Interest income	35,663	7,242,714	7,278,377
Administrative reimbursement fee	160,302	-	160,302
Contribution:			
Employer	-	8,762,286	8,762,286
Participant payroll deferral	-	27,575,359	27,575,359
Net investment gain/(loss)	8,449	(4,135,620)	(4,127,171)
Other revenue	134,358	-	134,358
<b>Total additions</b>	<b>457,898</b>	<b>39,444,739</b>	<b>39,902,637</b>
<b>DEDUCTIONS</b>			
Personal services	178,030	-	178,030
Workers compensation	3,273	-	3,273
Operating expenses	22,111	-	22,111
Indirect cost assessment	37,658	-	37,658
Administration and communication	76,341	-	76,341
Leased space	6,697	-	6,697
Legal services	3,349	-	3,349
Asset fees	-	96,837	96,837
Participant withdrawals	-	45,481,590	45,481,590
<b>Total deductions</b>	<b>327,459</b>	<b>45,578,427</b>	<b>45,905,886</b>
Change in net assets	130,439	(6,133,688)	(6,003,249)
<b>Net assets, beginning of year</b>	<b>693,433</b>	<b>265,558,619</b>	<b>266,252,052</b>
<b>Net assets, end of year</b>	<b>\$ 823,872</b>	<b>\$ 259,424,931</b>	<b>\$ 260,248,803</b>



**Independent Auditors' 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 Legislation 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, 2004, and have issued our report thereon dated September 2, 2004. 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*.

### **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 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, upon release by the Legislative Audit Committee, this report is a matter of public record and its distribution is not limited.

*Jerry + Stephenson, P.C.*

Denver, Colorado  
September 2, 2004

**STATE OF COLORADO  
DEFERRED COMPENSATION PLAN  
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**Report Control number 1612**