LEGISLATIVE AUDIT COMMITTEE
2006 MEMBERS

Senator Jack Taylor
Chair

Senator Stephanie Takis
Vice-Chair

Representative Fran Coleman
Senator Jim Isgar
Representative James Kerr
Senator Nancy Spence
Representative Val Vigil
Representative Al White

Office of the State Auditor Staff

Sally Symanski
State Auditor

Dianne Ray
Deputy State Auditor

Clifton Gunderson LLP
Contract Auditors
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>SECTION</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Report Summary</td>
<td>1</td>
</tr>
<tr>
<td>Recommendation Summary</td>
<td>2</td>
</tr>
<tr>
<td>Current Year Findings and Recommendations</td>
<td>3</td>
</tr>
<tr>
<td>Disposition of Prior Year Recommendations</td>
<td>4</td>
</tr>
<tr>
<td>Reports of Independent Auditors</td>
<td>5</td>
</tr>
<tr>
<td>Exhibit I – Clifton Gunderson LLP Responsibility</td>
<td></td>
</tr>
<tr>
<td>Comprehensive Annual Report for the Year Ended December 31, 2005</td>
<td></td>
</tr>
</tbody>
</table>
To the Board of Trustees of
Colorado Public Employees’ Retirement Association

We have completed our audit of the financial statements of the Colorado Public Employees’ Retirement Association ("PERA") for the year ended December 31, 2005, and have issued an unqualified opinion thereon dated May 26, 2006. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

We were engaged to conduct our audit pursuant to Section 24-51-204(6) of the Colorado Revised Statutes, which authorizes the State Auditor to conduct or cause to conduct audits of PERA. Sections 2 and 3 of this report set forth the recommendations we have issued as part of our audit. Our audit opinion is located in the Comprehensive Annual Financial Report available from PERA.

Clifton Gunderson LLP

Denver, Colorado
May 26, 2006
SECTION 1
AUDIT REPORT SUMMARY
Audit of PERA Benefit Plans for the Year Ended December 31, 2005

Our audit of the December 31, 2005 financial statements of PERA is complete and we issued our unqualified report thereon dated May 26, 2006. There are no matters which we believe require the Audit Committee’s specific attention.

- The financial statements of PERA have been prepared in conformity with accounting principles generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

- The scope of our audit was reported to the PERA Audit Committee. There were no significant variations from the planned scope.

As part of our audit of the financial statements of PERA, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. Based on the results of our work, our review of PERA’s internal control has not disclosed any weaknesses which we believe to be material weaknesses under standards established by the American Institute of Certified Public Accountants. Refer to the Report on Internal Controls Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* on page 5-3. In addition, we examined PERA’s compliance over financial reporting with certain provisions as included in Colorado Revised Statues and PERA Rules. Based on the results of our work, our review of PERA’s compliance with certain provisions of laws, regulations, and contracts has disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, for the year ended December 31, 2005. Refer to the Report on Internal Controls Over Financial Reporting on Compliance and Other Matters Based on an Audit of Financial Standards Performed in Accordance with *Government Auditing Standards* on page 5-3.

**Cooperation with Management**

We are pleased to inform you that we received full cooperation of the officers and employees of PERA, and we were furnished with all of the information and explanations required to perform our audit.
Communications with Audit Committee

Our responsibility for assuring that the Audit Committee is made aware of significant matters, as required by our professional standards, is outlined in Exhibit I.

Independence

We reiterate our firm’s policy on independence, which stipulates that neither Clifton Gunderson LLP partners nor staff assigned to the audit of PERA are permitted to have any direct or material indirect interest in PERA. Adherence to the policy of independence is reaffirmed annually in writing by each member of our professional staff.

To the best of our knowledge, there are no circumstances or relationships between PERA and Clifton Gunderson LLP that would impair our independence in reporting on the PERA’s financial statements. We hereby confirm that as of May 26, 2006, we are independent accountants with respect to PERA.

Clifton Gunderson LLP

Denver, Colorado
May 26, 2006
SECTION 2
RECOMMENDATION SUMMARY
<table>
<thead>
<tr>
<th>Rec. No.</th>
<th>Page No.</th>
<th>Recommendation</th>
<th>PERA Response</th>
<th>Implementation Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3-2</td>
<td>Employee Criminal Background Checks</td>
<td>Agree</td>
<td>July 2006</td>
</tr>
<tr>
<td>2</td>
<td>3-4</td>
<td>Alternative Investments</td>
<td>Agree</td>
<td>Ongoing</td>
</tr>
<tr>
<td>3</td>
<td>3-6</td>
<td>Purchase Order System</td>
<td>Agree</td>
<td>First Quarter 2007</td>
</tr>
<tr>
<td>4</td>
<td>3-7</td>
<td>Amortization Liabilities</td>
<td>Agree</td>
<td>Ongoing</td>
</tr>
<tr>
<td>5</td>
<td>3-10</td>
<td>Oracle Password Configuration</td>
<td>Agree</td>
<td>April 2006</td>
</tr>
<tr>
<td>6</td>
<td>3-11</td>
<td>Employer Contribution System Edits</td>
<td>Agree</td>
<td>March 2006</td>
</tr>
<tr>
<td>7</td>
<td>3-13</td>
<td>Controls Over Keyed Access</td>
<td>Agree</td>
<td>March 2006</td>
</tr>
</tbody>
</table>
SECTION 3
CURRENT YEAR FINDINGS AND RECOMMENDATIONS
CURRENT YEAR FINDINGS AND RECOMMENDATIONS

We have audited the financial statements of Colorado Public Employees’ Retirement Association (“PERA”) for the year ended December 31, 2005 and have issued our report thereon dated May 26, 2006. In planning and performing our audit of the financial statements, we considered PERA’s internal control solely to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. We have not considered internal control or compliance over financial reporting since May 26, 2006.

Our procedures were designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist.

Recommendations noted in connection with the December 31, 2005 audit are detailed in the following pages.
PERA, an affiliated employer that administers the net assets of the Plan, has approximately 230 employees. The Plan’s net assets at December 31, 2005 were approximately $36 billion with Plan members in excess of 380,000.

**Issue:**
PERA processes a variety of transactions that require employee access to sensitive financial information, not only related to the entity but also to the Plan members. PERA employees are privy to participant information such as birth date and social security numbers. In addition, PERA members may provide financial information, such as bank account numbers, necessary for the direct deposit of benefit payments.

Section 24-5-101(1) C.R.S., states that the fact that a person has been convicted of a felony or other offense involving moral turpitude shall not, in and of itself, prevent the person from obtaining public employment. However, statutes do not prohibit public employers from conducting background checks and using this information as one factor to be considered when making employment decisions, such as when the felony conviction is related to the position under consideration for hire.

Currently, PERA does not require criminal background checks for employees. PERA evaluates potential employees using procedures such as interviews focused on evaluating an applicant’s honesty and judgment, checking references, scrutinizing prior employment terminations, investigating breaks in employment, and validating education. However, given the nature of the entity, it is critical that PERA consider all relevant information when making hiring decisions. For example, an applicant’s prior felony conviction for identity theft would be important for a prospective employer that handles sensitive financial information to be aware of and consider when making employment decisions.

The 2004 audit recommended that PERA require criminal background checks for employees with access to financial, demographic, or other sensitive information, and seek statutory change if needed. PERA agreed with the recommendation, and during the 2006 session, Senate Bill 06-6 was enacted. This bill clarifies PERA’s ability to include a criminal background check of job applicants with other checks that are part of the PERA employment process, if the position involves access to sensitive information. This legislation was effective as of March 31, 2006.

**Risk and Implication:**
PERA or member financial information could be used improperly or fraudulently.

**Recommendation:**
PERA should revise its hiring process to including required criminal background checks for employees with access to financial, demographic, or other sensitive information. The necessity and depth of the background check should be based on the employee’s position within the organization, and adequate safeguards should be in place with respect to handling information obtained.
PERA’s Response:
Agree. The Legislative Audit Committee of the Colorado General Assembly sponsored legislation in early 2006 that would allow PERA as an employer to obtain criminal histories on potential employees at the time of hire. Effective July 1, 2006, PERA will begin conducting pre-employment criminal background checks on all final candidates for employment. PERA may dismiss or reject any individual whose background check results are directly relevant to the individual’s job responsibility.
RECOMMENDATION NO. 2
ALTERNATIVE INVESTMENTS

PERA invests in several types of alternative investments including venture capital funds and leveraged buyouts representing in excess of 230 investments. At December 31, 2005, PERA reported total alternative investments of approximately $3.0 billion or 8 percent of total net assets of approximately $36 billion.

Issue:
PERA requires annual December 31 audited financial statements from the investment advisor for each alternative investment prior to March 31 each year. As a result of the 2003 audit recommendations, PERA formalized certain procedures for obtaining financial information from investment advisors for alternative investment vehicles where no audited financial information was provided. As a result of the 2004 audit recommendation, PERA identified all alternative investments that did not comply with the reporting policies to provide audited information by March 31 and sent letters notifying the investment advisors of the need to comply with these requirements.

The 2005 audit found that approximately 55 percent of the alternative investments representing 128 investments valued at approximately $1.3 billion that were tested for compliance were not supported by audited financial statements. In these cases, the investment advisor provides certain unaudited information representing an estimate of the value of the Plan’s investment prior to the March 31 reporting requirement. PERA’s investment staff then reviews the valuation for reasonableness. Because of the high proportion of alternative investment vehicles that lack audited financial information, by March 31, and the potential volatility of these investments, PERA should continue to work with investment advisors to improve compliance with the March 31 reporting requirement, and ensure that the Board of Trustees is informed of differences between estimated and audited valuations.

Risk and Implication:
The valuation of a significant number of the alternative investments is based on unaudited information. Since the financial information underlying the valuation has not been subjected to an independent objective evaluation by external auditors, the valuation may be less accurate than one based on audited information.

Recommendation:
PERA should continue to identify those alternative investments that do not comply with PERA’s required reporting policies to provide audited information by March 31 and notify investment advisors of the need to comply with these requirements. PERA should also continue to document and analyze the differences between estimated and audited valuations in cases where audited information was not received in time for inclusion in PERA’s audited financial statements, and provide such information to the Board of Trustees.
PERA’s Response:
Agree. PERA agrees with this recommendation and will continue to document and analyze the differences between estimated and audited valuations and notify advisors of the need for compliance with the stated reporting deadline. PERA continues to work closely with trade associations to collaborate and develop best practices in the industry to address this industry-wide issue.
During the year ended December 31, 2005, PERA incurred approximately $4.2 million in office supplies, printing, travel and other miscellaneous expenses.

**Issue:**
PERA does not obtain quotes or bids for purchases over a specific threshold or dollar amount and has not implemented a formal purchase order system. While these purchases only represent approximately 12 percent of PERA’s total administrative expenses of $35.7 million in 2005, PERA has a responsibility to ensure that all administrative expenses are reasonable. In addition, a formal purchase order system would allow PERA to establish improved and standardized documentation related to the purchasing process. For example, State Fiscal Rules require that state agencies and institutions have a purchase order to obtain goods and services over $5,000, except for specific exclusions.

PERA’s current accounting software system has a purchase order module that could be implemented to achieve this objective. PERA should also develop formal policies and procedures for obtaining sufficient documentation for all purchases including copies of receipts or other relevant documentation that should be attached to a completed purchase order.

The 2004 audit recommended that PERA implement a formal purchase order system and develop policies and procedures related to purchasing. PERA agreed with the recommendation and scheduled implementation for December 2005. After having accounting personnel attend seminars and analyzing the resources needed to implement a formal purchase order system with the module included in its current accounting software, the project was postponed until the Summer of 2006.

**Risk and Implication:**
There is a risk that purchases may not be made for the optimum price or may not include sufficient supporting documentation or approvals indicating that quotes or bids were obtained. Since PERA does not obtain quotes or bids for purchases over specified limits, the organization may be spending funds unnecessarily.

**Recommendation:**
PERA should implement a formal purchase order system and develop policies and procedures related to purchasing, such as establishing thresholds over which formal quotes or bids need to be obtained and approved prior to purchase and the documentation that should be maintained.

**PERA’s Response:**
Agree. PERA agrees with this recommendation and currently has an approved system development project to implement the requirements of this recommendation. PERA will be implementing a comprehensive purchasing system that is scheduled for launch during the first quarter of 2007.
RECOMMENDATION NO. 4
AMORTIZATION OF LIABILITIES

Issue:
As part of the preparation of its annual financial statements, PERA is required to estimate the unfunded liability for each of the three divisions that participate in the defined benefit plan offered to state employees. The total estimated unfunded liability as of December 31 is as follows:

<table>
<thead>
<tr>
<th>Division</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>State and School Division</td>
<td>$11,784,575</td>
<td>$12,188,832</td>
</tr>
<tr>
<td>Municipal Division</td>
<td>$663,905</td>
<td>$586,336</td>
</tr>
<tr>
<td>Judicial Division</td>
<td>$30,650</td>
<td>$39,843</td>
</tr>
<tr>
<td>Combined Unfunded Liability</td>
<td>$12,479,130</td>
<td>$12,815,011</td>
</tr>
</tbody>
</table>

Section 24-51-211, C.R.S., “Amortization of liabilities”, states:

“An amortization period for each of the state and school division, municipal division, and judicial division trust funds shall be calculated separately. A maximum amortization period of forty years shall be deemed actuarially sound. Upon recommendation of the Board, and with the advice of the actuary, the employer or member contributions rates for the Plan may be adjusted by the general assembly when indicated by actuarial experience.”

Through review of the 2005 Actuarial Valuation completed by Buck Consultants dated May 2006, it was noted that the remaining amortization period with current funding is infinite for each of the three divisions (i.e., state and school division, municipal division, and judicial division), as was the case as of December 31, 2005. In other words, the results of the valuation study indicated that under PERA’s current actuarial assumptions, none of the divisions are expected to receive sufficient contributions and earnings to fund all the benefits that PERA is obligated under current state law to pay. The funding ratios as of December 31 are as follows:

<table>
<thead>
<tr>
<th>Division</th>
<th>2005</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>State and School Division</td>
<td>72.7%</td>
<td>70.1%</td>
</tr>
<tr>
<td>Judicial Division</td>
<td>86.3%</td>
<td>77.2%</td>
</tr>
<tr>
<td>Municipal Division</td>
<td>78.0%</td>
<td>81.0%</td>
</tr>
<tr>
<td>Combined Funded Ratio</td>
<td>73.3%</td>
<td>70.6%</td>
</tr>
</tbody>
</table>

In addition, because the amortization period exceeds 40 years for all three divisions (not including the effects of Amortization Equalization Disbursement (AED) or Supplemental Amortization Equalization Disbursement (SAED)), the divisions are not considered actuarially sound under Section 24-51-211, C.R.S.
During the 2006 Session, PERA worked with the Governor and the General Assembly on the passage of Senate Bill 06-235. The major provisions of this bill include:

**Senate Bill 06-235. Concerning PERA Benefit Plans** (passed by the Legislature in May 2006, and signed by the Governor on May 25, 2006):

- Addition of a Supplemental Amortization Equalization Disbursement (SAED) that will begin in January 2008 at .5% per year up to 3%. The shut-off mechanism for the AED and SAED will be changed to 100% funding status on a division by division basis.
- New provisions for new hires after January 1, 2007. Maintain current 2.5% of Highest Average Salary (HAS) as the multiplier factor with a 3 year HAS and an 8% per year cap on salary escalation during HAS years. Change rule of 80 to rule of 85 with a minimum retirement age of 55. Implement a new Cost-of-Living Allowance (COLA) fund dedicated to new hire retirement COLA’s at the lower of 3% or the actual Consumer Price Index if retired 1 year and have reached age 60 or if age plus years of service equal 85, limited to available funds.
- The statutorily prescribed amortization period would be reduced from 40 to 30 years.
- A new statutory provision would be enacted that requires the General Assembly to contract for an independent actuarial study before future benefit increases could occur.
- A new requirement to purchase service at full actuarial cost would be enacted.
- Changes to the composition of the Board.
- Expansion of the choice of a defined contribution plan to Higher Education Institutions

PERA’s actuary has determined that the contribution rates are currently not sufficient to support the Plan’s benefit structure on a long-term basis. Prior to the passing of Senate Bill 06-235, the actuary reported that unless there is a significant recovery in the investment markets in the near future, it will be difficult to support the current level of benefits without significant increases in the contribution rates. The table below represents the current employer contribution rate, and the employer contribution rate that would be needed at the present time to amortize the unfunded actuarial accrued liability within a 40-year period, as reported by PERA.

**Employer Contribution Rates as of December 31, 2005:**

<table>
<thead>
<tr>
<th>Division</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Division</td>
<td>10.15%</td>
</tr>
<tr>
<td>State Troopers</td>
<td>12.85%</td>
</tr>
<tr>
<td>School Division</td>
<td>10.15%</td>
</tr>
<tr>
<td>Municipal Division</td>
<td>10.00%</td>
</tr>
<tr>
<td>Judicial Division</td>
<td>13.66%</td>
</tr>
</tbody>
</table>

**Employer Contribution Rates Needed for 40-Year Amortization as of December 31, 2005**

<table>
<thead>
<tr>
<th>Division</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Division</td>
<td>19.33%</td>
</tr>
<tr>
<td>School Division</td>
<td>19.33%</td>
</tr>
<tr>
<td>Municipal Division</td>
<td>14.11%</td>
</tr>
<tr>
<td>Judicial Division</td>
<td>17.21%</td>
</tr>
</tbody>
</table>
In addition, with the legislation passed in 2006 and under Governmental Accounting Standard No. 25 Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, effective for the year ended December 31, 2006, the maximum acceptable amortization period is 30 years.

Based on the current December 31, 2005 valuation, the actuary has calculated the following amortization periods for each fund including all future AED and SAED contributions which were not taken into consideration for the December 31, 2005 Actuarial Valuation:

<table>
<thead>
<tr>
<th>Division</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Division</td>
<td>Infinite</td>
</tr>
<tr>
<td>School Division</td>
<td>73 years</td>
</tr>
<tr>
<td>Municipal Division</td>
<td>20 years</td>
</tr>
<tr>
<td>Judicial Division</td>
<td>22 years</td>
</tr>
</tbody>
</table>

The known effect of the legislation has already corrected the Municipal and Judicial Divisions, and the above calculation of amortization periods only includes the effects of contribution changes from the 2006 legislation on the current populations at December 31, 2005.

**Recommendation:**
PERA should continue to monitor the effects of the 2006 legislation to determine if the changes will bring the State and School Divisions into compliance with a 30-year amortization. If further analysis indicates that the changes will not bring PERA into compliance, PERA should continue to work with the Governor and the General Assembly to seek changes in the employer and/or member contributions and other Plan provisions for the State and School Divisions to achieve a 30-year amortization period which is the maximum period deemed actuarially sound under the new legislation and the maximum acceptable period under Governmental Accounting Standard No. 25 Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, beginning in 2006.

**PERA’s Response:**
Agree. This recommendation was PERA’s highest priority during 2005 and efforts to address this issue were proposed in the form of significant 2006 legislation that was passed and signed into law in May. This legislation enhances the steps taken in 2004 to ensure the financial health of the PERA trust funds going forward by limiting liabilities and enhancing revenues toward achieving the required amortization schedule.
RECOMMENDATION NO. 5
ORACLE PASSWORD CONFIGURATIONS
REQUIRES ISD CORRECTIVE ACTION

Issue:
Oracle password configurations for database administrators (DBA’s) could be strengthened to ensure compliance with Information Systems Department policies.

PERA utilizes Peoplesoft for its general ledger, accounts payable, benefits, human resources, payroll and time and labor functionality. The Peoplesoft application (version 8.8) utilized by PERA runs on an Oracle database, which is administered by database administrators (DBA’s). PERA has two DBA’s responsible for database administration, performance and tuning operations, and maintaining database availability. They are also responsible for the overall operation of the database, capable of installing changes to schema objects; tables, indexes, views, and procedures.

All Peoplesoft users, including DBAs, are assigned to a profile, which defines the roles and permissions they have access to within the application. Users are configured to follow the password and account parameters defined with the default profile, unless assigned to a different profile with different settings. Each database has their own distinct set of profiles. We reviewed password configuration strength and compliance with related PERA policies and procedures.

Based upon our review of the default profile assigned to DBA’s (on three Peoplesoft databases), several password parameters (i.e. failed login attempts, password lifetime, and password reuse) were determined not in compliance with PERA information system policies, and set to default settings.

Risk and Implication:
Utilizing default password parameters for powerful database administrator accounts or not complying with PERA information system policies could expose sensitive PERA data to unauthorized access, modification, or deletion.

Recommendation:
PERA should establish tighter controls over powerful accounts, such as database administrators (to mitigate the risk of unauthorized access) by ensuring password configurations for DBA’s are in compliance with Information System Department policies.

PERA’s Response:
Agree. PERA agrees with this recommendation and has implemented a new security profile for Oracle Database Administrators that adheres with internal Information Systems’ policy.
RECOMMENDATION NO. 6
EMPLOYER CONTRIBUTION SYSTEM EDITS
REQUIRES JOINT ISD/PERA MANAGEMENT CORRECTIVE ACTION

Issue:
There are no built in system edits or reports to flag or identify wages reported to PERA by affiliated employers that are missing or appear out of the norm, such as large bonuses or missing monthly wages, at the time or year of occurrence. (Prior year Recommendation #9)

During 2005, PERA paid a total of $1,971,082,785 in benefits to retirees. These retirees included 70,968 Benefit Recipients representing 61,940 regular retirements, 7,424 disability retirements and 1,604 survivor benefits. According to PERA, as of December 2005, it had 95,645 Active Non-Vested members, and 91,411 Active Vested members for a total of 187,552.

Clifton Gunderson (CG) reviewed the benefits calculation/retirement process with the PERA Benefits Counselor/Team Leader. We determined that counselors manually review monthly wages and contributions over the member’s entire service period (up to 30 years) and investigate discrepancies (e.g. out of the ordinary or missing amounts) in employer reported information. This process occurs at the time a member has notified PERA that he or she plans to retire.

PERA affiliated employers contribute a percentage of their total payroll to the PERA Plan each month. While there are not built in edits or reports to flag or identify wages that appear out of the norm, there is a process in place where the Team Leader randomly samples 5% of all benefit forms processed each week by counselors (for members that are about to retire), checking for accuracy and reasonableness.

In our Fiscal Year 2004 audit, we reported that based upon discussions with the PERA IT Director and Internal Audit Director, there is a Member Information Accuracy Project underway to improve controls over the accuracy of contribution and wage information provided by participating employers. This effort involves the issuance of various Requests for Change (RFCs) to the Information System Department (ISD) to put certain procedures and edits in place on a staggered basis. For example, one RFC in process involves an edit check to ensure all employee contributions equal 8% of the reported wages, which is the current employee contribution rate. Additionally, CG identified a group of edits called “After Post” In-house Edits, one item which specifically targets salary variances. This edit is intended to identify a member’s salary fluctuations that appear questionable. This planned edit is similar to the missing flag (edit) implemented on the front end of contribution reporting by employers.

Our follow-up during the Fiscal Year 2005 audit determined that PERA has started to implement the proposed RFCs identified as part of the Member Information Accuracy Project. RFC number 907, entitled “Enhanced Contribution Reporting Edits” defines ten new categories of contribution system edits that will improve front-end accuracy of contribution reporting from
employers to PERA. Examples of these edits include: 1) salary can only be reported one time in selected fields and cannot be greater than $50,000, 2) life insurance premiums cannot be negative and must be less than $312.01, etc. RFC 907 was approved on 12/16/05, resources became available to begin work on 1/31/06 and the RFC is currently in the implementation phase.

Based upon our review of the actions taken to date by PERA, CG determined that this issue is still open.

Risk and Implication:
PERA’s internal quality review process could potentially not identify contribution reporting errors for as much as 20-30 years after the discrepancy took place. After lengthy periods of time, personnel and records needed to clarify contribution errors may no longer be available or very difficult to obtain. Also, since the Team Leaders responsible for testing the accuracy of benefit calculations perform these tests on a small, randomly selected sample (5%) of benefit calculations for members about to retire, there is the possibility that salary aberrations missed by benefit counselors would not be detected.

Recommendation:
PERA should continue to implement the initiatives and edits identified within the Member Information Accuracy Project to improve the accuracy of contributions reporting from employers to PERA and to reduce the risk of incorrect benefit payments. This recommendation requires joint ISD and PERA management corrective action.

PERA’s Response:
Agree. PERA agrees with this recommendation and completed the implementation of RFC 907 on March 13, 2006.
RECOMMENDATION NO. 7
CONTROLS OVER KEYED ACCESS
REQUIRES PERA MANAGEMENT CORRECTIVE ACTION

Issue:
Controls over keyed access to PERA facilities should be improved to ensure upon separation of employment with PERA, keys are returned to building management.

PERA presently has 227 employees. During 2005, a total of 24 individuals separated employment from PERA. Physical keys to the building are requested back upon an employee’s separation and are included on the HR termination checklist.

Presently, only Penn and Pointe building management maintain a listing of key inventory. The Human Resources department has not been provided copies of key inventories based upon discussions with building management.

These keys provide access to various PERA areas including the Pointe PERA’s offsite backup location. PERA does have however, detective controls in place including forced door alarms and closed circuit television cameras, which are actively monitored on a 24/7 basis. These controls provide management with evidence of security breaches involving physical keys for follow up.

Risk and Implication:
Access to PERA facilities by unknown users increases the risk of unauthorized access to PERA assets. If keys providing access to PERA facilities are not returned upon an employees’ separation of employment from PERA, unauthorized individuals or disgruntled former employees could use these keys to access, modify or destroy PERA property and data.

Recommendation:
PERA should ensure that Human Resources routinely receives up to date listings of all building master keys provided by building management to all PERA staff. These listings should be utilized by Human Resources to reclaim keys upon an employee’s separation of employment from PERA.

PERA’s Response:
Agree. In March of this year, Property Management provided Human Resources with the names of the eight building maintenance employees who have physical keys. Human Resources has implemented a procedure that requires the collection of these keys upon termination of these specific individuals. It should be noted that PERA monitors all access to PERA property via 24/7 video camera surveillance, and that all entrances to internal areas essential to PERA’s operation are electronically secured.
SECTION 4
DISPOSITION OF PRIOR YEAR RECOMMENDATIONS
DISPOSITION OF PRIOR YEAR RECOMMENDATIONS

The following are the audit recommendations included in the Colorado Public Employees’ Retirement Association audit report for the year ending December 31, 2004, and their disposition as of December 31, 2005.

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Disposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Criminal Background Checks</td>
<td>Recommendation No. 1</td>
</tr>
<tr>
<td>Alternative Investments</td>
<td>Recommendation No. 2</td>
</tr>
<tr>
<td>Purchase Order System</td>
<td>Recommendation No. 3</td>
</tr>
<tr>
<td>Amortization of Liabilities</td>
<td>Recommendation No. 4</td>
</tr>
<tr>
<td>Windows and AS/400 Password</td>
<td>Implemented 2005</td>
</tr>
<tr>
<td>Program Developer Segregation of Duties</td>
<td>Implemented 2005</td>
</tr>
<tr>
<td>Review of User Accounts and access</td>
<td>Implemented 2005</td>
</tr>
<tr>
<td>Date of Birth Edit Controls</td>
<td>Implemented 2005</td>
</tr>
<tr>
<td>Employer Contribution System Edits</td>
<td>Recommendation No. 6</td>
</tr>
<tr>
<td>Information Security Policies</td>
<td>Implemented 2005</td>
</tr>
</tbody>
</table>
SECTION 5
REPORTS OF INDEPENDENT AUDITORS
Independent Auditor’s Report

Board of Trustees
Colorado Public Employees’ Retirement Association
Denver, Colorado

We have audited the accompanying statements of fiduciary net assets and the related statement of changes in fiduciary net assets of the Colorado Public Employees’ Retirement Association as of and for the year ended December 31, 2005 which collectively comprise Colorado Public Employees’ Retirement Association’s basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Colorado Public Employees’ Retirement Association’s management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Colorado Public Employees’ Retirement Association’s December 31, 2004 financial statements, and in our report dated May 23, 2005, we expressed an unqualified opinion on the respective financial statements.

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. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Colorado Public Employees' Retirement Association’s internal control over financial reporting. Accordingly, we express no such opinion. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Colorado Public Employees’ Retirement Association as of December 31, 2005, and related changes in fiduciary net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.
In accordance with Government Auditing Standards, we have also issued a report dated May 26, 2006, on our consideration of Colorado Public Employees' Retirement Association’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management’s discussion and analysis on pages 21 through 33, and the schedule of funding progress and schedule of employer contributions on pages 54 through 56 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Colorado Public Employees' Retirement Association’s basic financial statements. The supplementary schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The introductory section, investment section, actuarial section and statistical section listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Clifton Gunderson LLP

Denver, Colorado
May 26, 2006
Board of Trustees  
Colorado Public Employees’ Retirement Association  
Denver, Colorado

We have audited the financial statements of the Colorado Public Employees’ Retirement Association (PERA) as of and for the year ended December 31, 2005 and have issued our report thereon dated May 26, 2006. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered PERA’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 that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the PERA’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 or other matters that are required to be reported under Government Auditing Standards.
This report is intended for the information of the Colorado Public Employees’ Retirement Association Board of Trustees and management of PERA and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Clifton Gunderson LLP

Denver, Colorado
May 26, 2006
Independent Auditor’s Report

To the Board of Trustees of
Colorado Public Employees’ Retirement Association

We have examined Colorado Public Employees’ Retirement Association’s (“PERA”) compliance with PERA Rules and the Colorado Revised Statutes related to financial reporting during the year ended December 31, 2005. The following sections were specific to our review:

- **PERA Rules**
  - 2.90 Actuarial Assumptions
  - 4.40 Refunds
  - 5.30 Payments for Purchase Service Credits
  - 5.40 Interest Rate
  - 10 Increase in Benefits
  - 10.30 Retroactive Effective Date of Retirement or Survivor Benefit

- **Colorado Revised Statutes**
  - 24-51-206 Investments
  - 24-51-208 Allocation of Moneys
  - 24-51-210 Allocation of Assets and Liabilities
  - 24-51-211 Amortization of Liabilities
  - 24-51-401 Employer and Member Contributions
  - 24-51-405 Refund of a Members Contribution Account
  - 24-51-406 Payments from the Judicial Division
  - 24-51-407 Interest (Member Contributions)
  - 24-51-503 Purchase of Service Credit Related to a Refunded Account
  - 24-51-603 Benefit Formula for Service Retirement
  - 24-51-1206 Health Care Premium Subsidiary
  - 24-51-1403 Expenses of Voluntary Investment Program (VIP)

Management is responsible for PERA’s compliance with those requirements. Our responsibility is to express an opinion on PERA’s compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about PERA’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on PERA’s compliance with specified requirements.
In our opinion, PERA complied, in all material respects, with the aforementioned requirements for the year ended December 31, 2005.

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

Clifton Anderson LLP

Denver, Colorado
May 26, 2006
EXHIBIT I
CLIFTON GUNDERSON LLP RESPONSIBILITY
May 26, 2006

Audit Committee
Colorado Public Employees' Retirement Association

The purpose of this letter is to provide you with information about significant matters related to our audit of the basic financial statements of Colorado Public Employees' Retirement Association (the Association) for the years ended December 31, 2005, in order to assist you with your oversight responsibilities of the financial reporting process, and so that we may comply with our professional responsibilities to the Audit Committee. This letter is intended solely for the information and use of the Audit Committee and is not intended to be and should not be used by anyone other than this specified party.

We have provided under separate cover a letter, dated May 26, 2006, concerning the internal control conditions that we noted during our audit of the Association’s financial statements for the years ended December 31, 2005.

Auditor’s Responsibility Under Generally Accepted Auditing Standards. Our audit of the financial statements of Colorado Public Employees' Retirement Association for the year ended December 31, 2005, was conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement. Reasonable assurance in an audit is obtained by examining evidence supporting the amounts and disclosures in the financial statements on a test basis. An audit does not include verification of all transactions and account balances, nor does it represent a certification of the absolute accuracy of the financial statements.

In testing whether the basic financial statements are free of material misstatement, we focus more of our attention on items with a higher potential of material misstatement, and less on items that have a remote chance of material misstatement. For this purpose, accounting literature has defined materiality as “the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.”

An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Although we may make suggestions as to the form and content of the financial statements, or even prepare them in whole or in part, the financial statements remain the representations of management. In
an audit, our responsibility with respect to the financial statements is limited to forming an opinion as to whether the financial statements are a fair presentation of the Association’s financial position, results of operations, and cash flows.

**Significant Accounting Policies.** There were no significant accounting policies or their application which were either initially selected or changed during the year. In addition, there were no significant, unusual transactions in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

**Management Judgments and Accounting Estimates.** Significant estimates include management’s estimate of the valuation of certain investments not traded on exchanges and certain real estate investments. These estimates are based on periodic relevant financial information, the value of comparables, independent appraisals or other relevant data. Significant estimates also include an estimate of the Association’s actuarial liabilities based on an actuarial valuation.

Our conclusion regarding the reasonableness of the valuation of investments and the actuarial liabilities was based primarily on recalculation, comparison to third party information and analytical procedures.

**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 Association’s financial statements or our report on those financial statements.

**Consultations With Other Accountants.** We were informed by management that they made no consultations with other accountants on the application of generally accepted accounting principles and generally accepted auditing standards.

**Major Issues Discussed With Management Prior to Retention.** There were no major issues, including the application of accounting principles and auditing standards, which were discussed with management prior to our retention as auditors.

**Difficulties Encountered in Performing the Audit.** There were no difficulties in dealing with management related to the performance of our audit.

We will be pleased to respond to any questions you have regarding the foregoing comments.
The electronic version of this report is available on the Web site of the Office of the State Auditor
www.state.co.us/auditor

A bound report may be obtained by calling the Office of the State Auditor
303-869-2800

Please refer to the Report Control Number below when requesting this report.

Report Control Number 1760