

State of Colorado Deferred Compensation Plan

Accountants' Report and Financial Statements

June 30, 2007 and 2006

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State of Colorado Deferred Compensation Plan

June 30, 2007 and 2006

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State of Colorado
Deferred Compensation Plan
Report Summary
June 30, 2007 and 2006

Purposes and Scope of Audit

The purposes and scope of this audit:

- Express an opinion on the statement of fiduciary net assets and the related statement of changes in fiduciary net assets of the State of Colorado Deferred Compensation Plan (the Plan) as of and for the year ended June 30, 2007, including consideration of internal control over financial reporting as required by auditing standards generally accepted in the United States of America and *Government Auditing Standards*.
- Evaluate compliance with certain provisions of laws, regulations, and contracts for the year ended June 30, 2007.
- Issue a report on the Plan's compliance with certain provisions of laws, regulations, and contracts and on internal control over financial reporting based on our audit of the financial statements performed in accordance with *Government Auditing Standards*.
- Evaluate progress in implementing prior year audit recommendations.

Summary of Major Audit Comments

Audit Findings and Financial Statement Audit Report Section

The Description of Audit Findings and Recommendations section contains the following:

- The employee compensation used to calculate participant deferral contributions to the Plan is not in accordance with the Plan Document.
- The Plan's management is not receiving complete information from Great-West Life and Annuity Insurance Company (Great-West), the Plan's record keeper, regarding all participating employers.
- Great-West is not consistently disbursing participant benefits in accordance with approved amounts.
- Employee salary deferral information is not being supplied to central payroll or Great-West for recording.
- The Plan is not currently reviewing delinquent loans and reclassifying those that are delinquent for at least two quarters as "deemed distributions."

State of Colorado
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Report Summary (continued)
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Summary of Progress in Implementing Prior Audit Recommendations

The report for the year ended June 30, 2006, which is dated September 29, 2006, included five recommendations. One recommendation was implemented, three recommendations are partially implemented, and one recommendation has not been implemented.

Audit Opinions and Reports

The independent accountants' reports included herein expressed unqualified opinions on the Plan's statements of fiduciary net assets as of June 30, 2007 and 2006, and the related statements of changes in fiduciary net assets for the years then ended and the accompanying supplemental schedules. These financial statements and schedules are the responsibility of the Plan's management.

No instances of noncompliance considered material to the financial statements were disclosed by the audit.

We noted certain areas in which the Plan could improve its internal controls and other procedures. These areas are discussed in the Description of Audit Findings and Recommendations section of this report. Included in the Description of Audit Findings and Recommendations section of this report is one material weakness and one significant deficiency.

A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Plan's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Plan's financial statements that is more than inconsequential will not be prevented or detected by the Plan's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Plan's internal control.

Significant Audit Adjustments

Areas in which corrected misstatements were aggregated during the current engagement and pertaining to the latest period presented were determined by management to be material, both individually and in the aggregate, to the financial statements as a whole. These areas included the following:

- A portion of the Plan relating to employees of Jefferson County School District was not being recorded in the Plan's financial statements as of and for the year ended June 30, 2007, because Great-West presents these account balances separately from other participating employers under the Plan.

The effect of the corrected misstatements was to increase the Plan's investments by \$5,973,021, accounts receivable by \$3,507, fees by \$9,938, participant distributions by \$186,064, participant

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contributions by \$4,706,532, interest income by \$108,759 and net investment gain by \$396,202 for the year ended June 30, 2007.

Areas in which corrected misstatements were aggregated during the current engagement and pertaining to the earliest period presented were determined by management to be material, both individually and in the aggregate, to the financial statements as a whole. These areas included the following:

- A portion of the Plan relating to employees of Jefferson County School District was not being recorded in the Plan's financial statements as of and for the year ended June 30, 2006, because Great-West presents these account balances separately from other participating employers under the Plan.

The effect of the corrected misstatements was to increase the Plan's investments by \$961,037, fees by \$1,388, participant distributions by \$769, participant contributions by \$972,022 and interest income by \$2,612, and to decrease net investment gain by \$11,440 for the year ended June 30, 2006.

Areas in which uncorrected misstatements were aggregated during the current engagement and pertaining to the latest period presented were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole. These areas included the following:

- Participant deferral election documentation is not currently centralized for local school districts. Discrepancies were noted between the initial participant deferral election on file and the amount currently being deferred. Additionally, the compensation used for calculating participant deferrals is not in accordance with the Plan Document.

The effect of the uncorrected misstatements, had they been recorded, would have been to decrease the Plan's investments by approximately \$307,000 and participant contributions by approximately \$307,000 for the year ended June 30, 2007.

Areas in which uncorrected misstatements were aggregated during the current engagement and pertaining to both the latest and earliest periods presented were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole. These areas included the following:

- Per the Plan Document, delinquent participant loans that are not paid up-to-date by the end of the calendar quarter after the calendar quarter in which a payment is first delinquent will be in default and considered a "deemed distribution" and reported to the Internal Revenue Service as income to the participant.

The effect of the uncorrected misstatements, had they been recorded, would have been to decrease the Plan's accounts receivable by approximately \$86,000 and \$99,000 at June 30, 2007 and 2006, respectively, decrease participant withdrawals by approximately \$13,000 for the year ended June 30, 2007, and increase participant withdrawals by approximately \$99,000 for the year ended June 30, 2006.

**State of Colorado
Deferred Compensation Plan
Recommendation Locator
Year Ended June 30, 2007**

Recommendation Number	Page Number	Recommendation Summary	Response	Implementation Date
1	9	Use the correct compensation, as specified in the Plan Document, for calculating participant payroll deferrals.	Agree	June 2008
2	10	Obtain adequate support to ensure that all participating employers' participant accounts are properly included in the Plan's financial statements.	Agree	October 2008
3	12	Reconcile participant distributions to approved distribution amounts.	Agree	June 2008
4	13	Record, at a central location, all participant deferral elections.	Agree	Implemented / October 2008 / April 2008
5	15	Classify loans properly as "deemed distributions" based on participant non-payment for two consecutive quarters.	Agree	June 2008

State of Colorado Deferred Compensation Plan

Description of the Plan June 30, 2007 and 2006

Description and Background

The State of Colorado Deferred Compensation Plan (the Plan) was established in 1981 to provide state employees and officials with a means of investing a portion of their state compensation on a tax-deferred basis. The Plan is governed by a nine-member Deferred Compensation Committee. 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.
- One governor's appointee who is a participant in the Public Officials' and Employees' Defined Contribution Plan.
- 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 & Administration (the Department). Statutory authority for the Plan and Deferred Compensation Committee is referenced in Sections 24-52-101 to 24-52-105, C.R.S. The record keeper for the Plan for fiscal year 2007 is Great-West Life and Annuity Insurance Company (Great-West).

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, under SB04-132. In January 2004, the Plan implemented a loan program. Participants may request one loan each from the Plan and the 401(a) match plan. The loans are limited to the lesser of 50% of the participant's vested account balance or \$50,000.

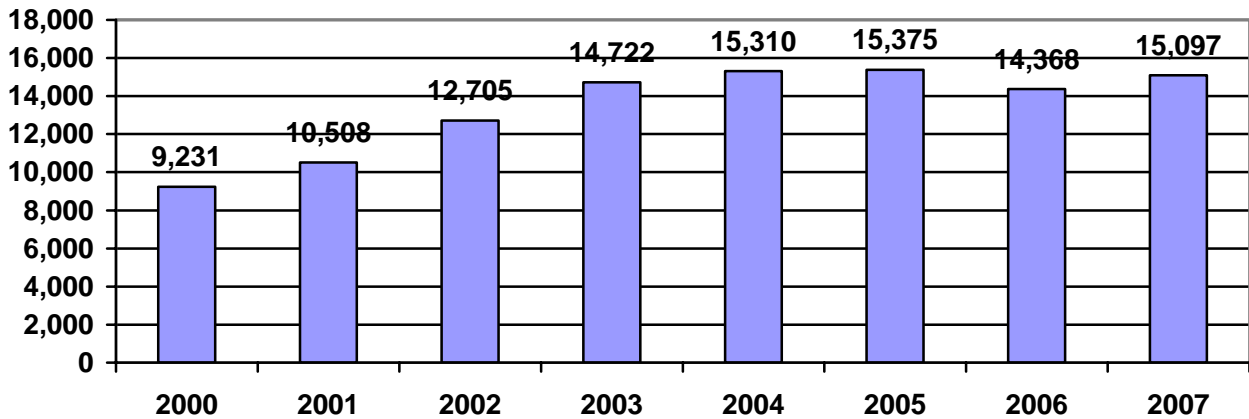
Growth of the Plan

The following graph shows a steady increase in total participants for fiscal years 2000 through 2005 and another increase in 2007, while 2006 shows a decline in participation caused by the enacted forced distributions described below. The increase in participation for fiscal years 2001 through 2005 was 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 Plan. Additionally, the employer match and the advantages offered under the Economic Growth Tax Relief & Reconciliation Act of 2001 (EGTRRA), which provided purchase of service credit, increased portability and contribution limits among 457, 401(k), and 403(b) plans has increased participation

**State of Colorado
Deferred Compensation Plan
Description of the Plan (continued)
June 30, 2007 and 2006**

in the Plan. In 2006 the number of total participant accounts dropped due to a forced distribution directed by the Committee and authorized in the Plan Document. The forced distributions consisted of terminated employees with account balances less than \$1,000. The increase in participation for fiscal year 2007 is due to school districts being allowed to participate in the Plan effective January 1, 2006, including Jefferson County School District with 733 participants in the Plan at June 30, 2007.

457 PLAN PARTICIPANTS



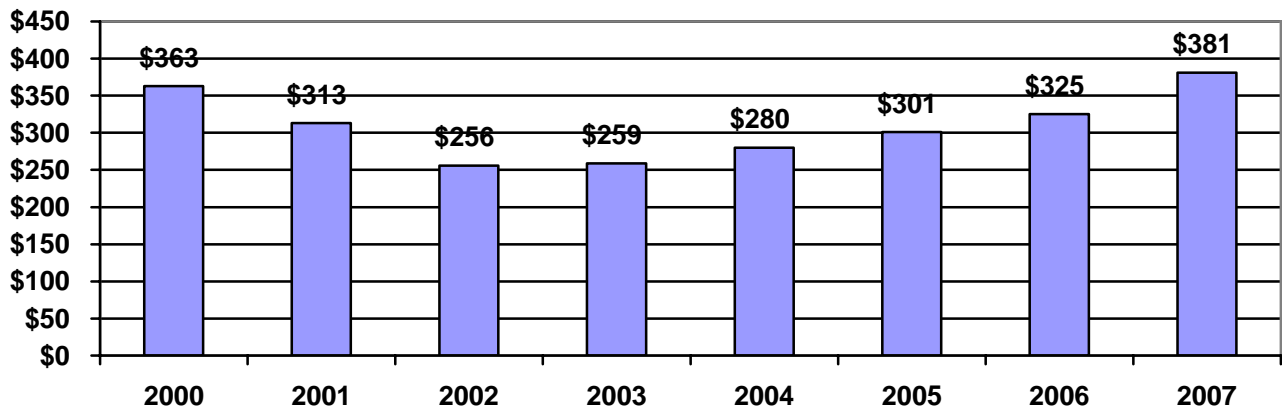
Source: 2000-2007 Great-West Retirement Services

As shown in the chart below, the Plan's assets have increased from a low of \$256 million as of June 30, 2002, to \$381 million as of June 30, 2007. The increase in assets is attributable to the participation by school districts beginning January 1, 2006, as well as the offering of the employer match (offered from January 2001 through May 2004), which attracted more participants to the Plan and additional monthly contributions. The increase in assets from 2005 through 2007 is attributable to net gains earned on invested assets. The graph shows the change in the value of total assets, in millions, from June 30, 2000, through June 30, 2007.

**State of Colorado
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Description of the Plan (continued)
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457 PLAN ASSETS

(In millions)



Source: 2000-2007 Great-West Retirement Services

Administrative Fee

The Plan's Committee continues to review the administrative fee on an annual basis in conjunction with the Department of Personnel & Administration's financial services staff, who 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 administrative fee based on the analysis.

Effective July 1, 2005, the fee was revised and new contracts were established. Based on industry trends and the proposal submitted by Great-West, the administrative fee was increased to \$20 per participant per year (from \$9 per participant per year). In order to comply with the 1% limitation in accordance with Section 24-52-102(5)(a), C.R.S., the Department charges no fee to new participants for the first year and thereafter until the participant's account balance reaches \$2,000.

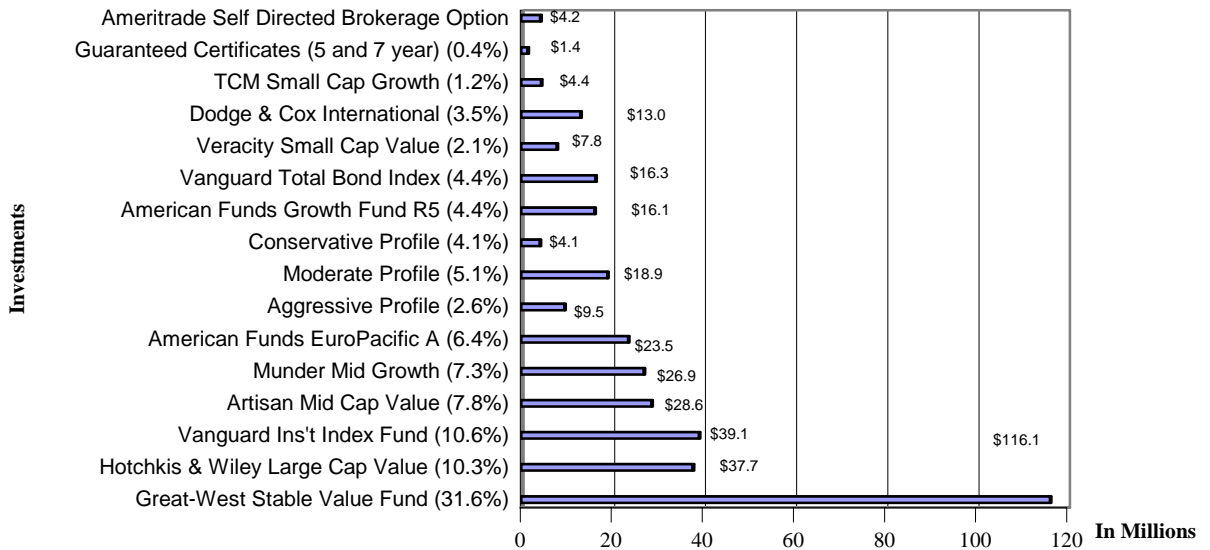
After the first year of this contract, the fee schedule was reviewed again. Due to the excess of fund balance, as a result of the previous five-year contract with Great-West, the Committee reduced the administrative fee to \$0 for fiscal year 2007. Since the excess fund balance resulted from participants' investments and fees associated with those investments, the Plan's Committee determined that the excess fund balance could be used to cover operational costs and that it was unnecessary to charge participants an administrative fee.

**State of Colorado
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June 30, 2007 and 2006**

Plan Investment Options

The Plan offers participants the opportunity to invest in 12 different investment options from nine companies. Two additional options that are closed to new contributions include Great-West 7-year Guaranteed Certificates and Great-West 5-year Guaranteed Certificates (five-year certificates were completely liquidated prior to June 30, 2006). The Plan added a self-directed brokerage option in 2001. 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) by investment options as of June 30, 2007. 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.

Distribution of Plan Assets



The total Plan assets, shown in the above graph, do not include purchased annuities of \$5.4 million. See Note 2 of the financial statements.

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Description of Audit Findings and Recommendations
June 30, 2007

Definition of Compensation

According to the amended Plan Document, compensation for purposes of calculating participant contributions to the Plan (eligible compensation) excludes amounts that are deducted for IRS Section 125 (non-taxable employee deductions for allowable expenses such as medical, dental, child care and parking) reimbursement elections.

We tested 100 Plan participants for the proper calculation of contributions to the Plan based on the employees' election forms, as provided by Great-West. We compared the amounts withheld from participants' pay to the amounts contributed to the Plan, as shown on the Plan contribution statements for each respective participant. For participants electing to contribute a percentage of compensation, we determined whether the Plan Document's definition of eligible compensation (eligible wages from which retirement plan contributions are withheld) was being applied to participant compensation used to calculate participant contributions.

The Plan allows participants to contribute either fixed dollar amounts or a percentage of the participant's compensation each pay period. We noted 16 out of 100 participants tested (16 percent) contribute a percentage of compensation to the Plan. From the 16 participants noted contributing a percentage of their compensation, 13 participants made contributions that were calculated based on the participants' gross compensation, which is prior to deductions under Section 125 and which is not in accordance with the Plan Document.

Although the Plan was amended during 2005 to exclude IRS Section 125 deductions from eligible compensation for the purpose of determining contribution amounts, the change was not implemented through the State of Colorado's payroll process. Plan management indicated that they interpreted the definition of compensation to include participant compensation prior to any IRS Section 125 deductions, which is not consistent with the Plan Document.

As a result of the misinterpreted definition of eligible compensation, participants under the Plan who had elected a contribution based on a percentage of compensation had greater amounts deducted from their compensation than if the correct definition of eligible compensation had been applied.

Recommendation No. 1

The Department of Personnel & Administration should implement controls to ensure that participant contributions are calculated on eligible compensation, as defined in the Plan Document. Additionally, the Department of Personnel & Administration should consult with legal counsel to determine the appropriate action, if any, that should be taken with regard to correcting errors in participant contributions withheld from employee pay and take actions to correct relevant participant accounts as deemed necessary.

Department's Response

Agree. Implementation Date: June 2008

State of Colorado
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Description of Audit Findings and Recommendations (continued)
June 30, 2007

The Department will develop a process to randomly select Plan participants and then verify that the participants' contributions were calculated based on the appropriate definition of compensation. This process will occur on a quarterly basis. The Department is working with legal counsel to determine the appropriate action to correct the error noted by the auditors.

Unrecorded Participant Accounts

Since January 2006, the Plan has allowed local school districts and local governments within the State of Colorado to participate under the Plan. Under Section 24-52-101(4), C.R.S., any person, including elected officials, employed by and receiving compensation from the State of Colorado or any city and county, county, city, town, or other political subdivision is permitted to become a participant under the Plan. Since January 2006, 11 school districts have begun participating in the Plan, constituting approximately \$8,787,000 in Plan assets as of June 30, 2007.

Upon commencement of participation in the Plan by Jefferson County School District (the District) on January 1, 2006, Great-West administered the District's investment activity, including investment gains and losses, contributions and distributions, separately from other participating employers under the Plan. However, Great-West did not notify Plan management of the separate reporting of participant accounts relating to employees of the District and the Plan's need to include the information in its financial records. Additionally, when the independent auditors confirmed the Plan assets as of June 30, 2007 and 2006, with Great-West, no indication was provided by Great-West that the Plan financial records did not include activity relating to the District's participant accounts.

The result of the undisclosed District's portion of the Plan was an approximate \$5,973,000 and \$961,000 understatement of Plan assets at June 30, 2007 and 2006, respectively, representing the accounts of 733 and 424 District participants, respectively. Plan management charged with oversight of the Plan was unaware that the District participant accounts, and related activity, were not included in the Plan's investment statements. Although requests for distributions, loans, and hardship withdrawals for participants of the District were properly approved by appropriate Plan personnel, the actual activity of the Plan, including investment gains and losses, contributions and distributions, relating to employees of the District had not been provided by Great-West and were not being recorded by Plan Management on the Plan's financial statements.

Recommendation No. 2

The Department of Personnel & Administration should implement the necessary controls to ensure that all Plan assets are properly recorded in the Plan's financial statements. This should include developing a process for statewide reconciliations of Plan contributions to participating employers' payroll records, and reviewing Great-West's processes for recording the Plan assets of other participating employers within the Great-West recordkeeping system.

Department's Response

Agree. Implementation Date: October 2008

State of Colorado
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Description of Audit Findings and Recommendations (continued)
June 30, 2007

The Department is working with all employers participating in the Plan to establish a reconciliation process for contributions and distributions. Once established, this reconciliation will be performed on a quarterly basis. Additionally, the Department has established a consistent recording and reporting process for all employers within the Plan with Great-West.

In general, the Department believes the problems identified during the audit would be less likely to occur if the Deferred Compensation Plan was administered by PERA. Retirement savings plans are more directly within PERA's core functions and competencies and may be best placed there. This is especially true with the expansion of the 457 beyond state employees to other public employers, namely school districts. This expansion places additional demands on Department staff to perform work related to other employers on behalf of the Committee and Plan. PERA is already structured and accustomed to dealing with different public employers, e.g., school and local government divisions. The Department is consulting with the Deferred Compensation Plan Committee and PERA regarding this potential change.

Distribution Errors

Under the governing documents of the Plan, participants are eligible to request distributions for various purposes. Qualifying requests for distributions consist of hardship withdrawals, retirement distributions, qualified domestic relations order distributions (under proceedings of a divorce court), and death beneficiary distributions. Currently, Plan management does not have adequate procedures in place to ensure that non-termination participant distributions are made in accordance with approved distribution requests.

We selected a total of 44 participant distributions for testing. Our testing included comparing the distribution amount requested by the participant with the actual amount distributed. We noted two exceptions during our testing of distributions and both exceptions resulted in the participants receiving a distribution in excess of the requested or allowed distribution amount.

First, one participant requested a hardship withdrawal for the entire balance of the participant's retirement account. The participant had a loan outstanding of approximately \$1,800 on the date of the request and in order to adequately secure the participant's loan, a balance equaling or exceeding the outstanding loan balance was required to remain in the participant's account. The Hardship Committee (the approving committee consisting of three members of the Deferred Compensation Committee) properly approved the hardship distribution, appropriately reducing the distribution amount by the balance of the participant's outstanding loan balance. However, Great-West misinterpreted the Committee's approval of a full participant distribution less the participant's outstanding loan balance and paid the participant the full account balance. As a result, Great-West distributed an excess of \$1,800, and the participant's outstanding loan balance became unsecured. If the participant terminates employment with the State of Colorado prior to repaying the loan, the Plan would be at risk of not being able to collect the outstanding amount due.

Second, during the testing of participant distributions, we noted one participant who received a distribution amount in excess of the approved distribution amount. This error was the result of Great-West distributing approximately \$732 in excess of the amount approved by the Public Employees Retirement Association (PERA) for the purchase of retirement service credits. The

State of Colorado
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Description of Audit Findings and Recommendations (continued)
June 30, 2007

participant received the excess distribution from Great-West while employed by the State of Colorado.

The two errors in participant account distributions that we noted resulted from Great-West's failure to follow the Hardship Committee's and PERA's directions.

Recommendation No. 3

The Department of Personnel & Administration should implement controls to ensure all non-termination participant distributions processed by Great-West are in accordance with approved distribution requests by performing reconciliations of non-termination distributions made by Great-West with approved non-termination distribution requests and to timely investigate and resolve any identified discrepancies.

Department's Response

Agree. Implementation Date: June 2008

The Department will develop a process to compare all non-termination distributions, including PERA purchase of service requests, with the distribution requests to ensure their accuracy. The Department will follow up on any discrepancies noted.

Documentation of Participant Contribution Elections

Participant contributions constitute the primary source of additions to the Plan. Because the Plan encompasses approximately 15,500 participants employed by the State of Colorado, various cities, counties, towns and political subdivisions, centralized oversight of changes to participant contribution elections is important to help ensure compliance with IRS regulations regarding participant contributions to the Plan. The Department of Personnel & Administration (Department) has established procedures to ensure that participant contribution elections and changes are properly documented through either Great-West's participant website or written requests submitted to Great-West. These procedures primarily are communicated by the Department by sending e-mail reminders to the payroll officers of the various State agencies and to the payroll departments of the various participating cities, counties, towns and political subdivisions. In the event a participant submits this written request to his or her respective payroll department, the payroll personnel are required to forward this written request to Great-West.

The primary purpose for processing all participant contribution elections or changes through Great-West is to provide a centralized record of all participant contribution elections or changes. Great-West then communicates these elections or changes to the State's central payroll department or the participating cities, counties, towns and political subdivisions, as applicable, so that the relevant payroll systems can be updated. For certain exceptions, the Department staff that manages the Plan may authorize payroll personnel to make an election or change; those instances must be approved in advance by Department staff.

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June 30, 2007

We noted nine participants out of 100 participants tested (9%) that did not have adequate documentation maintained by Great-West to support the participant's current contribution election. Department staff subsequently provided support for four of the nine exceptions we had initially identified; however, we did not receive adequate evidence to determine if the actual amounts deferred for the remaining five participants were consistent with their elected contribution rates. Fiscal year 2007 contributions for these five participants totaled \$72,807, of which contributions of \$24,307 were not substantiated by adequate documentation of changes to these participants' contribution elections.

The Department should ensure that Great-West maintains the appropriate supporting documentation for contribution elections. The Department should also ensure that payroll staff within the participating divisions is appropriately trained on established procedures for changing participant contribution elections and the required documentation to be maintained in those instances where changes have been approved by the Department.

Recommendation No. 4

The Department of Personnel & Administration should ensure adequate documentation is maintained to support participant contribution elections by performing the following:

- a. Continuing to train the payroll officers of the various State agencies and the payroll departments of the various participating cities, counties, towns and political subdivisions on the established procedures for changing participant contribution elections and the required documentation to be maintained for pre-approved election changes.
- b. Conducting periodic audits to determine if amounts contributed are supported by adequate documentation maintained at Great-West and, in instances where discrepancies are identified, performing the follow-up as appropriate.
- c. Following up on and resolving the five contribution amounts identified during the audit that did not have adequate supporting documentation.

Department's Response

- a. Agree. Implementation Date: Implemented

The Department currently provides quarterly training opportunities as well as monthly Communiqués (notices) to HR Administrators and well as payroll administrators. However, the Department has limited ability to compel agency staff to attend training, so the understanding of the systems depends on cooperation of the agencies to attend the training DPA provides. Where there are approvals by the Department, appropriate documentation will be maintained.

- b. Agree. Implementation Date: October 2008

The Department will establish a process for periodic reviews of contributions for accuracy. The Department will resolve any discrepancies identified in a timely manner.

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Description of Audit Findings and Recommendations (continued)
June 30, 2007

c. Agree. Implementation Date: April 2008

The Department will follow up and resolve the five contribution amounts identified during the audit.

Default Participant Loans

The Plan Document provides operating guidelines for transactions occurring within the Plan. The guidelines provide details of the circumstances under which loans become classified as “default / delinquent.” The Plan Document also describes regulations pertaining to participant contributions, participant distributions, and participant loans.

Under the Plan, participants with outstanding loans are required to have payments withheld from their regular compensation pay. When a participant terminates employment, payroll deductions cease. When payments have not been received on a participant’s loan balance for two consecutive quarters, the loan is classified as delinquent. After payment has not been received on a participant loan for longer than one quarter, Great-West notifies the participant of the non-payment indicating that after one additional quarter, the outstanding loan balance will be considered disbursed and the participant will be taxed on the outstanding loan balance as if it were a distribution from the Plan. Great-West generates a report for the Plan’s management that lists all participant loans that are classified as delinquent. This report also details the most recent date a payment was received on each individual participant loan balance. We reviewed the default loan balances contained on the August 22, 2007 “Late/Defaulted Loans Report” obtained from Great-West. The value of loans in default totaled approximately \$86,000 and \$99,000 at June 30, 2007 and 2006, respectively.

For those participants with a loan in default status, Great-West provides a taxable distribution form containing the default loan balance for the calendar year in which the loan defaulted; Great-West also sends the taxable distribution form to the Internal Revenue Service. Although Great-West appropriately provides participants with a taxable distribution form, Great-West does not remove these defaulted loans from the Plan’s assets until the participant requests an account distribution, at which point the defaulted loan balance and unpaid accrued interest is reported as a distribution within the Plan’s financial statements. Great-West maintains these defaulted loan balances within the Plan’s assets for tracking purposes, as these defaulted loans are still considered outstanding loans and the participants have the ability to subsequently repay these defaulted loans.

These defaulted loans are to be reported as a distribution from the Plan during the year in which the default occurs and are not to continue to be reported as Plan assets until the participant resumes repayment under the loan. The Plan’s financial statements reported \$35,000 as distributions for defaulted loans relating to participants that had a loan in default and requested an account distribution in fiscal year 2007; however, only \$22,000 of loans should have been reported as a distribution in fiscal year 2007. Distributions for fiscal year 2007 were overstated by approximately \$13,000, loans receivable were overstated by approximately \$86,000 at June 30, 2007, and fiduciary net assets at June 30, 2006, were overstated by approximately \$99,000.

State of Colorado
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Description of Audit Findings and Recommendations (continued)
June 30, 2007

Recommendation No. 5

The Department of Personnel & Administration should adjust distributions from the Plan for defaulted loans when the loan default occurs and work with Great-West to develop a reconciliation process for defaulted loans.

Department's Response

Agree. Implementation Date: June 2008

The Department will continue to work on and with Great West to develop a reconciliation process for defaulting loans in order to ensure loans receivable is accurately stated at year-end.

State of Colorado
Deferred Compensation Plan
Disposition of Prior Audit Recommendations
June 30, 2007 and 2006

Summary of Progress in Implementing Prior Audit Recommendations

The audit report for the year ended June 30, 2006 included five recommendations. The disposition of these audit recommendations as of September 2007 was as follows:

Recommendation Number	Recommendation	Disposition
1	Distribute excess participant contributions within prescribed time constraints.	Partially implemented. The Department still relies on a system edit in central payroll to prevent any excess contributions for those employees paid through central payroll. For those employees paid through other payroll systems (four-year colleges and school districts), the Department will review the excess contributions report from Great-West annually and follow up with appropriate staff at the other payroll locations to ensure excess contributions to the Plan are disbursed timely. Implementation Date: December 2007
2	Reconcile contributions to the Plan on a basis no less than monthly.	Partially implemented. Due to staffing changes in the Department, reconciliations are still in the process of being implemented. Reconciliation procedures have been written and the Department is planning to begin the process in December 2007. Implementation Date: December 2007
3	Record, at a central location, all participant deferral elections.	Partially implemented. The Department provided several training opportunities and written communications to the various payroll and personnel officers during fiscal year 2007. The Department is in the process of developing a report to identify any changes made to the 457 field in the payroll system when payroll administrators make participant deferral changes. Plan staff will then use this report to follow up with the respective payroll administrators to 1) request the administrator to reverse the change before payroll runs, 2) explain the proper procedures to the administrator.

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Disposition of Prior Audit Recommendations (continued)
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Recommendation Number	Recommendation	Disposition
4	Classify loans properly as “deemed distributions” based on participant non-payment for two consecutive quarters.	Not implemented. After further discussion with Great-West, the Department was informed that because a participant with an outstanding defaulted loan has the opportunity to pay on the defaulted loans at any time, Great-West continues to report the loan as outstanding. Great-West indicated that they could not provide the Department with details regarding the payment by a participant on a defaulted loan. The Department agrees that the collectibility of defaulted participant loans is minimal and will continue to work with Great-West to determine a method of reconciling or reporting these types of loans.
5	The Department has not provided financial reports in a timely manner.	Implemented. The Department timely provided financial reports to the auditors.



Independent Accountants' Report on Financial Statements and Supplementary Information

Members of the Legislative Audit Committee:

We have audited the accompanying statements of fiduciary net assets of the State of Colorado Deferred Compensation Plan (the Plan) as of June 30, 2007 and 2006, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 State of Colorado Deferred Compensation Plan are intended to present the fiduciary net assets and the changes in fiduciary net assets for only that portion of the financial reporting entity of the State of Colorado that is attributable to the transactions of the State of Colorado Deferred Compensation Plan.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Colorado Deferred Compensation Plan as of June 30, 2007 and 2006, and its changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2007, 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 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 on 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 accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the

Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the Plan's basic financial statements taken as a whole. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis and is 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.

/s/ BKD, LLP

December 17, 2007, except for Note 8 as to which the date is February 3, 2008

State of Colorado
Deferred Compensation Plan
Management's Discussion and Analysis
June 30, 2007, 2006, and 2005

The following discussion and analysis is supplementary information required by the Governmental Accounting Standards Board (GASB) and is intended to provide background and summary information for the State of Colorado Deferred Compensation Plan (the Plan). This discussion and analysis should be read in conjunction with the Description of the Plan on pages 5–8 and the financial statements, including notes, which begin on page 27.

The Plan is governed by a Deferred Compensation Committee and is staffed by the Employee Benefits Unit within the Department of Personnel & Administration.

There are two financial statements presented for fiduciary funds. The Statements of Fiduciary Net Assets indicate the net assets available to pay future payments and give a snapshot at a particular point in time. The Statements of Changes in Fiduciary Net Assets provide a view of the additions and deductions to the Plan.

Below is a comparison of fiscal years' 2005, 2006 and 2007 financial activity for the Plan. Specific notable items are as follows:

Revenue Change

As indicated in the comparison, the Plan did not receive an administrative reimbursement fee in fiscal year 2007 as it had in fiscal years 2006 and 2005. Additionally, new revenue amounts (reallowances/explicit fees) were received in fiscal years 2006 and 2007 but not in fiscal year 2005. The changes in funding sources were due to a new contract with the third-party administrator that was effective July 1, 2005.

Financial Highlights

Plan assets increased \$55.9 million or 17% from 2006 to 2007 due to increased participation in the Plan and improved economic conditions, coupled with a decrease in participant withdrawals. The Plan experienced a \$24.4 million or 283% increase in net investment gain, excluding interest income, from 2006 to 2007 due to improved economic conditions.

Participant contributions increased \$3.8 million or 10% from 2006 to 2007 due to increased participation in the Plan, including a full year of participation by employees of the Jefferson County School District and related rollovers from previous plans.

The Economic Growth Tax Relief & Reconciliation Act of 2001 (EGTRRA) allows plan participants to use the amounts invested in the Plan to purchase PERA Service Credits. Participant withdrawals decreased by \$5.3 million or 14% in 2007 compared to 2006 as a result of the increased cost to purchase PERA Service Credits.

The administrative fees' income increased over 200% from 2005 to 2006 due to an increase in the annual participant fee from \$9 to \$20 from 2005 to 2006. This same fee was reduced to \$0 in 2007, which accounted for the decrease between 2006 and 2007.

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Management's Discussion and Analysis (continued)
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Accounts receivable increased 44% from 2005 to 2006, and 16% from 2006 to 2007 due to an increase in the number and average amount of loans. At June 30, 2007, 2006 and 2005, the outstanding loans receivable totaled \$2,876,241, \$2,446,992 and \$1,832,055, respectively. Specifically, the number of loans increased from 772 in 2005 to 908 in 2006, and to 1,112 in 2007. In addition, the average loan amount in 2005 was \$2,373 as compared to \$2,695 in 2006 and \$2,587 in 2007.

Operations and administrative fee deductions declined 13% in 2007 as compared to 2006, as a result of fewer minimum distributions to participants and these deductions increased in 2006 from 2005 by 103% as a result of a change in accounting for revenues and expenses. Specifically, in 2005 the revenues and expenses were netted by Great West, but for 2006, the Plan received fees and expenses at gross amounts.

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Management's Discussion and Analysis (continued)
June 30, 2007, 2006, and 2005

Deferred Compensation Plan Administration Fund Fiduciary Net Assets

	June 30, 2007	June 30, 2006	June 30, 2005	Percentage Change from 2006	Percentage Change from 2005
Assets					
Plan assets	\$ 377,442,949	\$ 321,953,636	\$ 301,234,877	17%	7%
Accounts receivable	3,129,630	2,700,102	1,876,093	16%	44%
Other assets	827,859	831,708	861,518	0%	-3%
Total assets	<u>381,400,438</u>	<u>325,485,446</u>	<u>303,972,488</u>	17%	7%
Liabilities					
Vouchers payable and accrued liabilities	209,317	226,039	169,577	(7%)	33%
Compensated absences - annual and sick leave	9,308	8,473	7,237	10%	17%
Total liabilities	<u>218,625</u>	<u>234,512</u>	<u>176,814</u>	(7%)	33%
Net Assets					
Held in trust for pension benefits and other purposes	<u>381,181,813</u>	<u>325,250,934</u>	<u>303,795,674</u>	17%	7%
Total fiduciary net assets	<u>\$ 381,181,813</u>	<u>\$ 325,250,934</u>	<u>\$ 303,795,674</u>	<u>17%</u>	<u>7%</u>

State of Colorado
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June 30, 2007, 2006, and 2005

Deferred Compensation Administration Fund Changes in Fiduciary Net Assets

	June 30, 2007	June 30, 2006	June 30, 2005	Percentage Change from 2006	Percentage Change from 2005
Additions					
Interest income	\$ 13,654,093	\$ 12,745,858	\$ 8,704,729	7%	46%
Contribution					
Employer	-	-	1,260,182	0%	(100%)
Participant	41,229,420	37,389,921	34,627,962	10%	8%
Investment gain	33,054,987	8,634,600	6,080,207	283%	42%
Reallowance/explicit fees	848,139	970,715	334,652	(13%)	190%
	<u>88,786,639</u>	<u>59,741,094</u>	<u>51,007,732</u>	49%	17%
Deductions					
Operations	875,499	868,152	497,425	1%	75%
Administrative fees	231,083	407,627	129,768	(43%)	214%
Participant withdrawals	31,749,178	37,010,055	28,093,496	(14%)	32%
	<u>32,855,760</u>	<u>38,285,834</u>	<u>28,720,689</u>	(14%)	33%
Change in Fiduciary Net Assets	<u><u>\$ 55,930,879</u></u>	<u><u>\$ 21,455,260</u></u>	<u><u>\$ 22,287,043</u></u>	<u>161%</u>	<u>(4%)</u>

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June 30, 2007, 2006, and 2005

Below is a comparison of the 2007 Budget to Actual Operation Deductions:

Comparison of Fiscal Year 2007 Budget to Actual Deductions	Budget	Actual	Over/(Under)
Personal services	\$ 227,513	\$ 140,803	\$ (86,710)
Operating	11,292	10,855	(437)
Workers' compensation and risk management	4,995	4,995	-
Legal services	12,275	12,274	(1)
Capitol complex leased space	4,793	4,793	-
Indirect cost assessment	21,056	21,406	350
Administration and communication	<u>766,500</u>	<u>680,373</u>	<u>(86,127)</u>
 Total	 <u>\$ 1,048,424</u>	 <u>\$ 875,499</u>	 <u>\$ (172,925)</u>

State of Colorado
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Statements of Fiduciary Net Assets
June 30, 2007 and 2006

	2007 Pension Trust Fund	2006 Pension Trust Fund (Restated Note 8)
Assets		
Cash in bank with state treasurer	\$ 827,836	\$ 831,708
Accounts receivable	3,129,630	2,700,102
Prepaid expenses	23	-
Plan assets	<u>377,442,949</u>	<u>321,953,636</u>
Total assets	<u>381,400,438</u>	<u>325,485,446</u>
Liabilities		
Vouchers payable and accrued liabilities	209,317	226,039
Compensated absences - annual leave and sick leave	<u>9,308</u>	<u>8,473</u>
Total liabilities	<u>218,625</u>	<u>234,512</u>
Net Assets		
Held in trust for pension benefits and other purposes	<u>381,181,813</u>	<u>325,250,934</u>
Total fiduciary net assets	<u><u>\$ 381,181,813</u></u>	<u><u>\$ 325,250,934</u></u>

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Statements of Changes in Fiduciary Net Assets
Years Ended June 30, 2007 and 2006

	2007 Pension Trust Fund	2006 Pension Trust Fund (Restated Note 8)
Additions		
Administrative fees	\$ -	\$ 317,836
Interest income	13,654,093	12,745,858
Reallowance/explicit fees	848,139	652,879
Contribution		
Participant payroll deferral	41,229,420	37,389,921
Net investment gain	<u>33,054,987</u>	<u>8,634,600</u>
Total additions	<u>88,786,639</u>	<u>59,741,094</u>
Deductions		
Personal services	140,803	154,034
Workers' compensation and risk management	4,995	3,258
Operating expenses	10,855	16,425
Indirect cost assessment	21,406	10,422
Administration and communication	680,373	666,337
Leased space	4,793	7,511
Legal services	12,274	10,165
Administrative fees	231,083	407,627
Participant withdrawals	<u>31,749,178</u>	<u>37,010,055</u>
Total deductions	<u>32,855,760</u>	<u>38,285,834</u>
Change in Fiduciary Net Assets	55,930,879	21,455,260
Fiduciary Net Assets, Beginning of Year	<u>325,250,934</u>	<u>303,795,674</u>
Fiduciary Net Assets, End of Year, as Restated	<u><u>\$ 381,181,813</u></u>	<u><u>\$ 325,250,934</u></u>

State of Colorado
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Notes to Financial Statements
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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)(a)(I)(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 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 or any city and county, county, city, town or political subdivision. 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, unforeseeable emergency or purchase of service in the PERA Defined Benefit Plan.

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 Internal Revenue Service (IRS) has determined that the provisions of the Plan are in compliance with IRC Section 457 in a private letter ruling dated September 26, 2005.

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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.”

The investments include purchased annuity contracts from Great-West Life & Annuity Insurance Company (Great-West), which are recorded at their contract value of \$5,354,951 and \$5,784,379 as of June 30, 2007 and 2006, 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 \$372,087,998 and \$316,169,257 are recorded within the Pension Trust Fund at fair value at June 30, 2007 and 2006, respectively.

In fiscal year 2005, the Plan implemented Governmental Accounting Standards Board Statement No. 40 – Deposit and Investment Risk Disclosures. The standard primarily changes the required disclosures of investment credit quality and interest rate risk for debt instruments.

As of June 30, 2007, the Plan had the following investments in debt instruments:

Investment Type	Fair Value	Rating (Moody’s)
Bond mutual funds	\$ 133,930,647	Unrated
Guaranteed investment contracts	1,368,516	AA3

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Interest Rate Risk

Interest rate risk is the risk that changes in the market rate of interest will adversely affect the value of an investment. The Plan's investment policy for \$117.6 million of the \$133.9 million in debt instruments limits its investment maturities to an average duration of between two and five years.

Credit Quality Risk

Credit quality risk is the risk that the issuer or other counterparty to a debt security will not fulfill its obligations to the Plan. This risk is assessed by national rating agencies, which assign a credit quality rating for many investments. The Plan's investment policy for \$117.6 million of the \$133.9 million in debt instruments limits investments to those with a credit quality rating of AAA, except for corporate bonds that have an average quality rating of A, commercial banks domiciled in the United States, or A1/P1 rated commercial paper.

The debt securities held in guaranteed investment contracts are rated above A1 for commercial paper and the other investments listed as unrated consist of bond mutual funds that invest in numerous corporate and governmental debt securities.

The Committee regularly reviews the Plan's investment products' risk characteristics to ensure each is performing at an acceptable level.

Note 3: Administrative Component

Cash recorded in the Administration Pension Trust Fund at June 30, 2007 and 2006, 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 Administration 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 administrative fee. This fee is set by the Plan's Committee and may not exceed 1.0% 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)(a), C.R.S., any administrative fee collected in excess of expenditures shall be used to reduce participants' administrative 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, 2006, the fee was reduced from \$20 per participant per year (excluding those participants in payout) to \$0. This fee holiday was put into effect due to an excess

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fund balance (i.e., revenue collected in excess of expenditures) in the Administration Pension Trust Fund.

According to the Great-West contract, which began July 1, 2005, the Plan also receives a portion of the third-party administrator's fund operating expense fee (i.e., reallowance fee), and .20% of Plan assets invested in the Vanguard Total Bond, Vanguard Institutional Index, and Stable Value Funds (i.e., explicit fees).

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 (TPA) for a five-year period to perform basic administration and record keeping services. The current contract with the TPA began on July 1, 2005 and expires June 30, 2010. The Plan pays the TPA an annual \$39 fee per participant for these 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 TPA maintains all records detailing employee contributions, related earnings, account balances, and fees for individual participants.

Note 4: Other Pension Plans

Plan Description

All of the Department's employees, hired prior to January 1, 2006, participate in the Public Employees' Retirement Association (PERA) 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 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 an actuarial assessment and 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 P.O. Box 5800, Denver, Colorado 80217, by calling PERA at 1.800.759.PERA (7372), or by visiting www.copera.org.

Employees of the state personnel system (excluding those employed at higher education institutions) hired by the State after January 1, 2006, are allowed 60 calendar days from date of hire to elect to participate in either a defined contribution retirement plan administered by the State's Deferred Compensation Committee (State DC Plan), or a defined contribution retirement plan administered by PERA (PERA DC Plan) or the defined benefit retirement plan administered by PERA (PERA DB Plan). If no election is made, the employee becomes a member of the PERA DB Plan.

Prior to legislation passed during the 2006 session, higher education employees may have participated in Social Security, PERA's defined benefit plan, or the institution's optional retirement

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plan. Based on the 2006 legislation, higher education employees hired on or after January 1, 2008, would have had the additional option of participating in the State's defined contribution plan or PERA's defined contribution plan. However, 2007 legislation repealed that decision for the four-year colleges, but allowed retirement choice between the two PERA plans for employees of the community colleges. These plans are discussed in further detail below.

Employees electing either of the PERA retirement plans are allowed a one-time irrevocable election between the second and fifth year of employment to switch between the two plans. For those employees who switch from the PERA DC Plan to the PERA DB Plan, they may utilize their account balance to purchase service in the DB Plan once they have completed one year of service under the DB Plan. Employer contributions to both the State DC Plan and the PERA DC Plan are the same as the contributions to the PERA DB Plan, as defined in statute. Employee contributions are 100% vested for the State DC Plan. The PERA plans each have a graduated scale where vesting is 100% after five years. Vesting means the amount the employee owns or is eligible for at termination of employment or retirement.

Defined benefit plan members (except state troopers) vest after five years of service and are eligible for full retirement based on their original hire date as follows:

- Hired before July 1, 2005: age 50 with 30 years of service, age 60 with 20 years of service, or age 65 with five years of service.
- Hired between July 1, 2005, and December 31, 2006: any age with 35 years of service, age 55 with 30 years of service, age 60 with 20 years of service, or age 65 with five years of service.
- Hired on or after January 1, 2007: any age with 35 years of service, age 55 with 30 years of service, age 60 with 25 years of service, or age 65 with 5 years of service.

Members are also eligible for retirement benefits without a reduction for early retirement based on their original hire date as follows:

- Hired before January 1, 2007: age 55 with a minimum of five years of service credit and age plus years of service equals 80 or more.
- Hired on or after January 1, 2007: age 55 with a minimum of five years of service credit and age plus years of service equals 85 or more.

State troopers and judges compose a small percentage of plan members but have higher contribution rates, and state troopers are eligible for retirement benefits at different ages and years of service.

Members automatically receive the higher of the defined retirement benefit or money purchase benefit at retirement. Defined benefits are calculated as 2.5% times the number of years of service times the highest average salary (HAS). For retirements before January 1, 2009, HAS is calculated as 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 and limited to a 15% increase

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between periods. For retirements after January 1, 2009, or persons hired on or after January 1, 2007, more restrictive limits are placed on salary increases between periods used in calculating HAS.

Retiree benefits are increased annually based on the participant's original hire date as follows:

- Hired before July 1, 2005: 3.5%, compounded annually.
- Hired between July 1, 2005, and December 31, 2006: the lesser of 3% or the actual increase in the national Consumer Price Index.
- Hired on or after January 1, 2007: the lesser of 3% or the actual increase in the national Consumer Price Index, limited to a 10% reduction in a reserve established for cost of living increases related strictly to those hired on or after January 1, 2007. (The reserve is funded by 1% of the employer contributions for this population.)

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, his or her eligible children under the age of 18 (23 if a full-time student) or spouse may be entitled to a single payment or monthly benefit payments. If there is no eligible child or spouse, then financially dependent parents, beneficiaries, or the member's estate may be entitled to a survivor's benefit.

Employees who choose the State DC Plan are immediately 100% vested with the first payroll contribution. At any time that they terminate employment, they may take a distribution of the full account balance subject to applicable taxes, early withdrawal penalties and market fluctuations.

Employees who choose the PERA DC Plan are immediately vested for the employee portion of the contribution and 50% vested for the employer contribution for the first year and 10% each year thereafter until they reach five years of service or 100% for the employer contribution. At any time that they terminate employment, they may take a distribution of the full account balance subject to the vesting schedule, applicable taxes, early withdrawal penalties and market fluctuations.

Funding Policy

The contribution requirements of plan members and their employers are established, and may be amended, by the general assembly. Salary subject to PERA contribution is 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.

Most employees contribute 8.0% (10.0% for state troopers) of their salary, as defined in CRS 24-51-101(42), to an individual account in the plan. From July 1, 2006, to December 31, 2006, the State contributed 10.65% (13.35% for state troopers and 14.16% for the judicial branch) of the employee's salary. From January 1, 2007, through June 30, 2007, the State contributed 11.15% (13.85% for state troopers and 14.66% for the judicial branch). During all of fiscal year 2006–07, 1.02% of the employees' total salary was allocated to the Health Care Trust Fund.

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Per Colorado Revised Statutes, an amortization period of 30 years is deemed actuarially sound. At December 31, 2005, the division of PERA in which the State participates was under-funded with an infinite amortization period, which means that the unfunded actuarially accrued liability would never be fully funded at the current contribution rate.

In the 2004 legislative session, the general assembly authorized an amortization equalization disbursement (AED) to address a pension-funding shortfall. The AED requires PERA employers to pay an additional .5% of salary beginning January 1, 2006, another .5% of salary in 2007, and subsequent year increases of .4% of salary until the additional payment reaches 3.0% in 2012.

In the 2006 legislative session, the general assembly authorized a Supplemental Amortization Equalization Disbursement (SAED) that requires PERA employers to pay an additional one-half percentage point of total salaries paid beginning January 1, 2008. The SAED is scheduled to increase by one-half percentage point through 2013 resulting in a cumulative increase of three percentage points. For State employers, each year's one-half percentage point increase in the SAED will be deducted from the amount of changes to State employees' salaries, and used by the employer to pay the SAED. Both the AED and SAED will terminate when funding levels reach 100%.

Historically, members have been allowed to purchase service credit at reduced rates. However, legislation passed in the 2006 session required that future agreements to purchase service credit be sufficient to fund the related actuarial liability.

The Plan's contributions to the Defined Benefit Plan and the Health Care Trust Fund for the fiscal years ending June 30, 2007 and 2006, and were \$7,972, and \$9,039, respectively. These contributions met the contribution requirement for each year.

Note 5: Voluntary Tax Deferred Retirement Plans

PERA offers a voluntary 401(k) plan separate from the defined benefit pension plan and defined contribution retirement plan. The State offers a voluntary supplemental 457 deferred compensation plan separate from the State's defined contribution retirement plan. Certain agencies and institutions of higher education of the State offer 403(b) or 401(a) plans.

Note 6: Postretirement Health Care and Life Insurance Benefits

Health Care Program

The PERA Health Care Program (the 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; the Program was converted to a trust fund in 1999. 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. Effective July 1, 2000, the maximum monthly subsidy is \$230 per month for benefit recipients who are under 65 years of age and who are not eligible for Medicare;

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and \$115 per month for benefit recipients who are 65 years of age or older or who are under 65 years of age and entitled to Medicare. The maximum subsidy is based on the recipient having 20 years of service credit, and is subject to reduction by 5% for each year of service less than 20 years.

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 another carrier for prescription benefits, and with several health maintenance organizations providing services within Colorado. As of December 31, 2006, there were 42,433 enrollees in the plan.

Life Insurance Program

During fiscal year 2007, PERA provided its members access to a group decreasing term life insurance plan offered by UnumProvident in which 41,101 members participated. Active members may join the UnumProvident Plan and continue coverage into retirement. Premiums are collected by monthly payroll deductions or other means. In addition, PERA maintained coverage for 12,790 members under closed group plans underwritten by Anthem Life, Prudential, and New York Life.

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 outstanding per Plan at any given time. There are two types of loans available: general purpose with a duration of one to five years, or principal residence with a duration of one to 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 participants' 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 1% over the prime rate published in *The Wall Street Journal* on the first business day of the month in which the loan is approved. The interest rate is subject to

State of Colorado
Deferred Compensation Plan
Notes to Financial Statements
June 30, 2007 and 2006

change by the 457 Committee; however, the rate may not exceed 12% at any given time. Loan payments shall be made through payroll deduction on a monthly basis.

As of June 30, 2007, \$2,876,241 in loans and corresponding interest receivable were outstanding, consisting of 1,112 participant loans. The average loan amount was \$2,587.

As of June 30, 2007, there were 21 loans considered delinquent totaling \$47,000 and 27 loans in default totaling \$86,000. Participants are notified of delinquency at the end of the calendar quarter in which a missed payment occurs. The participant must make up missed payments by the end of the calendar quarter after the quarter of the first missed payment. If the missed payments are not made in full, 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.

Note 8: Restatement of Prior Year Financial Statements

Fiscal year 2006 has been restated to include the plan assets and changes therein relating to the accounts of the participating employees of Jefferson County School District (the District), which commenced participation in the Plan on January 1, 2006, and whose accounts were previously not included in the Plan's financial statements. This restatement increased previously reported June 30, 2006, fiduciary net assets and fiscal 2006 changes in fiduciary net assets of \$961,037.

Supplementary Information

State of Colorado
Deferred Compensation Plan
Combining Statement of Fiduciary Net Assets
June 30, 2007

	Fiduciary Fund Type		
	Pension Trust Funds		
	Administration	Deferred	
	(Appropriated)	Compensation	Total
	Plan (Non-	Plan (Non-	
	appropriated)	appropriated)	
Assets			
Cash in bank with state treasurer	\$ 827,836	\$ -	\$ 827,836
Accounts receivable	253,389	2,876,241	3,129,630
Prepaid expenses	23	-	23
Plan assets	-	377,442,949	377,442,949
	<u>1,081,248</u>	<u>380,319,190</u>	<u>381,400,438</u>
Total assets			
Liabilities			
Vouchers payable and accrued liabilities	209,317	-	209,317
Compensated absences - annual leave and sick leave	9,308	-	9,308
	<u>218,625</u>	<u>-</u>	<u>218,625</u>
Total liabilities			
Net Assets			
Held in trust for pension benefit and other purposes	862,623	380,319,190	381,181,813
	<u>862,623</u>	<u>380,319,190</u>	<u>381,181,813</u>
Total fiduciary net assets	<u>\$ 862,623</u>	<u>\$ 380,319,190</u>	<u>\$ 381,181,813</u>

State of Colorado
Deferred Compensation Plan
Combining Statement of Changes in Fiduciary Net Assets
Year Ended June 30, 2007

	Pension Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non- appropriated)	Total
Additions			
Interest income	\$ 39,677	\$ 13,614,416	\$ 13,654,093
Reallowance/explicit fees	848,139	-	848,139
Contribution			
Participant payroll deferral	-	41,229,420	41,229,420
Net investment gain	-	33,054,987	33,054,987
	<hr/>	<hr/>	<hr/>
Total additions	887,816	87,898,823	88,786,639
	<hr/>	<hr/>	<hr/>
Deductions			
Personal services	140,803	-	140,803
Workers' compensation and risk management	4,995	-	4,995
Operating expenses	10,855	-	10,855
Indirect cost assessment	21,406	-	21,406
Administration and communication	680,373	-	680,373
Leased space	4,793	-	4,793
Legal services	12,274	-	12,274
Asset fees	-	231,083	231,083
Participant withdrawals	-	31,749,178	31,749,178
	<hr/>	<hr/>	<hr/>
Total deductions	875,499	31,980,261	32,855,760
	<hr/>	<hr/>	<hr/>
Change in Fiduciary Net Assets	12,317	55,918,562	55,930,879
	<hr/>	<hr/>	<hr/>
Fiduciary Net Assets, Beginning of Year	850,306	324,400,628	325,250,934
	<hr/>	<hr/>	<hr/>
Fiduciary Net Assets, End of Year	<u>\$ 862,623</u>	<u>\$ 380,319,190</u>	<u>\$ 381,181,813</u>

State of Colorado
Deferred Compensation Plan
Combining Statement of Fiduciary Net Assets
June 30, 2006

	Fiduciary Fund Type Pension Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non- appropriated)	Total
Assets			
Cash in bank with state treasurer	\$ 831,708	\$ -	\$ 831,708
Accounts receivable	253,110	2,446,992	2,700,102
Plan assets	-	321,953,636	321,953,636
Total assets	<u>1,084,818</u>	<u>324,400,628</u>	<u>325,485,446</u>
Liabilities			
Vouchers payable and accrued liabilities	226,039	-	226,039
Compensated absences - annual leave and sick leave	<u>8,473</u>	<u>-</u>	<u>8,473</u>
Total liabilities	<u>234,512</u>	<u>-</u>	<u>234,512</u>
Net Assets			
Held in trust for pension benefit and other purposes	<u>850,306</u>	<u>324,400,628</u>	<u>325,250,934</u>
Total fiduciary net assets	<u><u>\$ 850,306</u></u>	<u><u>\$ 324,400,628</u></u>	<u><u>\$ 325,250,934</u></u>

State of Colorado
Deferred Compensation Plan
Combining Statement of Changes in Fiduciary Net Assets
Year Ended June 30, 2006

	Pension Trust Funds		
	Administration (Appropriated)	Deferred Compensation Plan (Non- appropriated)	Total
Additions			
Administrative fees	\$ 317,836	\$ -	\$ 317,836
Interest income	27,881	12,717,977	12,745,858
Reallowance/explicit fees	652,879	-	652,879
Contribution			
Participant payroll deferral	-	37,389,921	37,389,921
Net investment gain/(loss)	(8,880)	8,643,480	8,634,600
	<u>989,716</u>	<u>58,751,378</u>	<u>59,741,094</u>
Deductions			
Personal services	154,034	-	154,034
Workers' compensation and risk management	3,258	-	3,258
Operating expenses	16,425	-	16,425
Indirect cost assessment	10,422	-	10,422
Administration and communication	666,337	-	666,337
Leased space	7,511	-	7,511
Legal services	10,165	-	10,165
Asset fees	-	407,627	407,627
Participant withdrawals	-	37,010,055	37,010,055
	<u>868,152</u>	<u>37,417,682</u>	<u>38,285,834</u>
Change in Fiduciary Net Assets	121,564	21,333,696	21,455,260
Fiduciary Net Assets, Beginning of Year	<u>728,742</u>	<u>303,066,932</u>	<u>303,795,674</u>
Fiduciary Net Assets, End of Year	<u>\$ 850,306</u>	<u>\$ 324,400,628</u>	<u>\$ 325,250,934</u>



Independent Accountants' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Legislative Audit Committee:

We have audited the financial statements of the State of Colorado Deferred Compensation Plan (the Plan) as of and for the year ended June 30, 2007, and have issued our report thereon dated December 17, 2007, except for Note 8 as to which the date is February 3, 2008. 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 the Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness on the Plan's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Plan's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Plan's financial statements that is more than inconsequential will not be prevented or detected by the Plan's internal control. We consider the deficiency described in the Description of Audit Findings and Recommendations section of this report as Recommendation 1 to be a significant deficiency in internal control over financial reporting.

We consider the deficiency described in the Description of Audit Findings and Recommendations section of this report as Recommendation 2 to be a material weakness. A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Plan's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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*.

We noted certain matters that we reported in the Description of Audit Findings and Recommendations section of this report.

The Department's responses to the findings identified in our audit are described in the Description of Audit Findings and Recommendations section of this report. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Legislative Audit Committee, the Deferred Compensation Committee and the management of the Plan and is not intended to be and should not be used by anyone other than these specified parties.

/s/ BKD, LLP

December 17, 2007



Independent Accountants' Audit Committee Communication

Members of the Legislative Audit Committee:

As part of our audit of the financial statements of the State of Colorado Deferred Compensation Plan (the Plan) as of and for the year ended June 30, 2007, we wish to communicate the following to you.

Auditors' Responsibility under Auditing Standards Generally Accepted in the United States of America

An audit performed in accordance with auditing standards generally accepted in the United States of America (GAAS) is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing GAAS procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our contract with the State Auditor more specifically describes our responsibilities.

Significant Accounting Policies

The Plan's significant accounting policies are described in Note 1 of the audited financial statements.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of net assets and changes in net assets and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments that, in its judgment, are required to prevent the financial statements from being materially misstated. Some adjustments proposed were not recorded because their aggregate effect is not currently material; however, they involve areas in which adjustments in the future could be material, individually or in the aggregate.

Areas in which adjustments were proposed, including those which management recorded, include the following:

- A portion of the Plan relating to employees of Jefferson County School District was not being recorded in the Plan's financial statements as of or for the year ended June 30, 2007, because Great-West presents these account balances separately from other participating employers under the Plan. The effect of the corrected misstatements was to increase the Plan's investments by \$5,973,021, accounts receivable by \$3,507, fees by \$9,938, participant distributions by \$186,064, participant contributions by \$4,706,532, interest income by \$108,759 and net investment gain by \$396,202 for the year ended June 30, 2007.

- A portion of the Plan relating to employees of Jefferson County School District was not recorded in the Plan's financial statements as of or for the year ended June 30, 2006, because Great-West presented these account balances separately from other participating employers under the Plan. The effect of the corrected misstatements was to increase the Plan's investments by \$961,037, fees by \$1,388, participant distributions by \$769, participant contributions by \$972,022, and interest income by \$2,612, and to decrease net investment gain by \$11,440 for the year ended June 30, 2006.
- Participant deferral election documentation is not currently centralized for local school districts. Discrepancies were noted between the initial participant deferral election on file and the amount currently being deferred. Additionally, the compensation used for calculating participant deferrals is not in accordance with the Plan Document. The effect of the uncorrected misstatements, had they been recorded, would have been to decrease the Plan's investments by approximately \$307,000 and participant contributions by approximately \$307,000 for the year ended June 30, 2007.
- Per the Plan document, delinquent participant loans that are not paid up-to-date by the end of the calendar quarter after the calendar quarter in which a payment is first delinquent will be in default and considered a "deemed distribution" and reported to the Internal Revenue Service as income to the participant. The effect of the uncorrected misstatements, had they been recorded, would have been to decrease the Plan's accounts receivable by approximately \$86,000 and \$99,000 at June 30, 2007 and 2006, respectively, decrease participant withdrawals by approximately \$13,000 for the year ended June 30, 2007, and increase participant withdrawals by approximately \$99,000 for the year ended June 30, 2006.

This letter is intended solely for the information and use of the Legislative Audit Committee, the Deferred Compensation Committee and management of the Plan and is not intended to be and should not be used by anyone other than these specified parties.

/s/ BKD, LLP

December 17, 2007

State of Colorado
Deferred Compensation Plan
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