INTRODUCTORY

SECTION

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December 29, 2005

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 2005. This report is prepared by the Office of the State Controller and is submitted as required by Section 24-30-204 of the Colorado Revised Statutes. The State Controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and governmental accountability.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in net assets or fund balances of the major funds and nonmajor funds in the aggregate. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public in understanding the state's financial affairs.

Except as noted below, the basic financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles (GAAP) applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and except for the discretely presented component units, they are audited by the State Auditor of Colorado. The basic financial statements comprise the Management Discussion and Analysis (MD&A), financial statements, notes to the financial statements, and Required Supplementary Information. The MD&A, which begins on page 21, contains additional financial analysis and supplementary information that is required by GASB and should be read in conjunction with this transmittal letter. The schedules comparing budgeted to actual activity, included in the section titled Required Supplementary Information, are not presented in accordance with GAAP; rather, they reflect the budgetary basis of accounting which defers certain payroll and Medicaid expenditures to the following fiscal year. In addition to the basic financial statements, the CAFR includes; combining financial statements that present information by fund category, certain narrative information that describes the individual fund categories, supporting schedules, and statistical tables that present financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity as prescribed by GASB. The primary government is the legal entity that comprises the major and nonmajor funds of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university activities that are legally separate but have been blended with the accounts of the institution that is financially accountable for the activity.

The state's elected officials are financially accountable for other legally separate entities that qualify as discretely presented component units. The following entities are the discretely presented component units of the state:

University of Colorado Hospital Authority
Colorado Water Resources and Power Development Authority
Denver Metropolitan Major League Baseball Stadium District
University of Colorado Foundation
Colorado State University Foundation
Colorado School of Mines Foundation
University of Northern Colorado Foundation
CoverColorado

Additional information about these component units and other related entities is presented in Note 2 of the financial statements (see page 69). Audited financial reports are available from each of these entities.

PROFILE OF THE STATE OF COLORADO

Colorado became the thirty-eighth state of the United States of America when it was admitted to the union in 1876. Its borders encompass 104,247 square miles of the high plains and the Rocky Mountains with elevations ranging from 3,350 to 14,431 feet above sea level. The state's major economic sectors include agriculture, manufacturing, technology, tourism, energy production, and mining. Considerable economic activity is generated in support of these sectors by government, wholesale and retail trade, transportation, communications, public utilities, finance, insurance, real estate, and other services. Given the state's semi-arid climate, water resource development, allocation, and conservation are ongoing issues for state management.

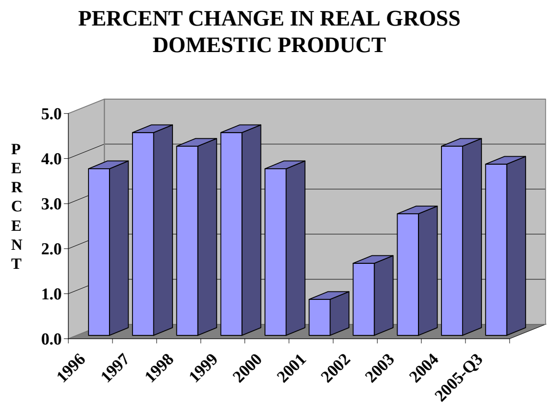
The state maintains a separation of powers utilizing three branches of government – executive, legislative, and judicial. The executive branch comprises four major elected officials – Governor, State Treasurer, Attorney General, and Secretary of State. Most departments of the state report directly to the Governor; however, the Departments of Treasury, Law, and State report to their respective elected officials, and the Department of Education reports to the elected State Board of Education. The elected officials serve four-year terms with the number of terms limited in duration.

The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited to the topics identified by the Governor. The Legislature's otherwise plenary power is checked by the requirement for the Governor's signature of its legislation and by specific limitations placed in the State Constitution by voters. The most significant fiscal limitation is the restriction related to issuing debt, raising taxes, and changing existing spending limits. From a fiscal perspective, the Joint Budget Committee of the Legislature, because of its preparation of the annual budget and supplemental appropriations bills, holds the most important power vested in the Legislature. The Committee is bipartisan with members drawn from each of the houses of the Legislature. The Governor's Office of State Planning and Budgeting develops an executive branch budget proposal, but there is no requirement for the Joint Budget Committee to adopt that proposal.

The Judicial Branch is responsible for resolving disputes within the state, including those between the executive and legislative branches of government, and for supervising offenders on probation. The branch includes the Supreme Court, Court of Appeals, and district and county courts, served by 256 justices and judges in 22 judicial districts across the state (excluding 17 Denver county court judges). Municipal courts are not part of the state system. There are also seven water courts, one in each of the major river basins. The Judicial Branch budget is appropriated by the Legislature, and it is funded primarily from general-purpose revenues of the General Fund.

ECONOMIC CONDITION AND OUTLOOK

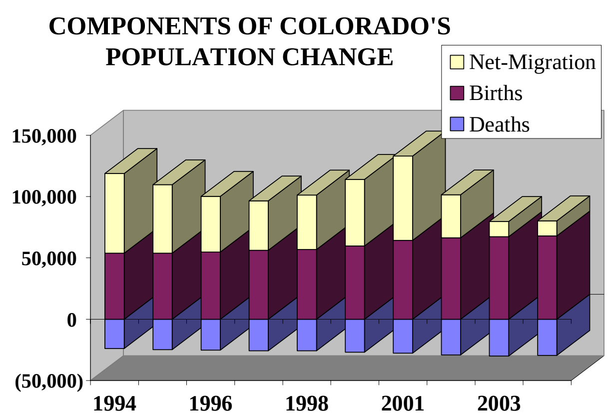
The state's General Fund revenue picture continued to rebound in Fiscal Year 2004-05. General Fund revenues were $394.4 million (6.8 percent) over the prior year amount; however, those revenues remained $194.5 million (3.1 percent) below the Fiscal Year 2000-01 record level. The general-purpose revenue growth parallels the reported 2004 state personal income growth of 5.8 percent. It also reflects a beginning recovery in state employment as 27,600 jobs were added in Fiscal Year 2003-04 and employment increased 2.3 percent in August 2005 – the tenth highest rate of increase in the nation.



The state's recovery from the most recent recession follows the national recovery although the state has recovered more slowly. Inflation adjusted national gross domestic product grew at an annual rate of 4.2 percent in calendar 2004, and in the third quarter of 2005, it grew at a 3.6 percent annual rate over the third quarter of 2004. National personal consumption expenditures, which account for two-thirds of GDP and were up 3.8 percent, outpaced the third-quarter to third-quarter average while private domestic investment (including nonresidential structures, equipment and software, residential, and changes in inventories) lagged the average at 3.4 percent. Government spending also lagged the average at a 2.1 percent growth rate and was primarily the result of slower growth in state and local government spending. Federal spending, while increasing, also lagged the third-quarter to third-quarter average growth rate.

The Denver-Boulder-Greeley index, which measures Colorado inflation, was extremely low in 2004 with consumer prices rising only .1 percent. Inflation remained low through August 2005 with prices up only 1.4 percent. Colorado inflation was controlled primarily by reductions in housing rental rates and incentives offered by automobile dealers. The high-wage jobs lost in the 2001 recession have also mitigated inflation pressures, as the job recovery has been slow since that time. A change in the method of computing the unemployment rate increased the 2004 percentage to 5.5 percent from 5.1 percent calculated under the old method; however, unemployment is forecast to decline in Fiscal Year 2005 as job growth continues. After two successive years of decline, housing permits increased 15.6 percent in 2004 while the value of nonresidential construction increased 26.3 percent.

Colorado's economic difficulties in Fiscal Year 2001-02 through 2003-04 have continued to affect net migration in calendar year 2004. Net in-migration declined from approximately 69,000 and 35,000 in 2001 and 2002, respectively, to approximately 12,000 in both 2003 and 2004. However, the 2004 amount includes international in-migration of approximately 22,000 and out-migration to other states of around 6,000. This pattern likely results in replacing established households that have a high level of economic activity with new households that have a lower level of economic activity. The information in the adjacent chart is based on current Census Bureau estimates. Data for the year 2000 is not included in the chart because a large adjustment was made to total state population for that year, and matching annual estimates for deaths and births are not available for that year.



The Governor's Office of State Planning and Budgeting (OSPB) has made the following forecast for Colorado's major economic variables:

- Employment growth will be above 2.3 percent in 2005 and above 2.6 percent for 2006.
- Unemployment will average 5.1 percent in 2005 and is expected to fall to 4.4 percent by 2007.
- Wages and salary income will grow by 6.1 percent in 2005, 5.7 percent in 2006, and will be over 6.0 percent growth by 2007.
- Total personal income will increase by 6.4 percent in 2005 and average about 6.7 percent growth by 2006, continuing through 2009.
- In-migration is expected to increase in 2005, and, as the economy recovers, the state's population growth rate will reach 1.6 percent by 2008.
- Total housing permits will decrease 6.7 percent in 2005 and the value of nonresidential construction will decline 9.2 percent.
- Colorado inflation will increase slightly in 2005 to 1.7 percent and will be 2.2 percent by 2006.

MAJOR GOVERNMENT INITIATIVES

The legislature passed significant legislation to implement measures recently placed in the State Constitution by voters and to address the fiscal impact of other voter approved constitutional requirements. The legislation was generally of two types. The first type was legislation that was immediately effective upon passage and signature by the Governor; the second type was legislation that was contingent on a vote of the people at the November 1, 2005, general election.

Legislation that was immediately effective on signature included the following:

- House Bill 05-1310 required the state to change its accounting for TABOR refunds made in excess of the TABOR constitutional requirements. (TABOR is explained in detail in the Management Discussion and Analysis on page 28.) The change allowed the state to take credit for TABOR refunds made for which it previously did not receive credit. The change reduced the amount of TABOR refunds due to the state taxpayers for Fiscal Year 2004-05 by $222.5 million.

- Senate Bill 05-209, the annual appropriations bill, included funding of an Amortization Equalization Disbursement beginning January 2006 that is intended to begin addressing the decline in funding status of the Public Employees Retirement Association.

- House Bills 05-1261 created the Tobacco Tax Cash Fund to receive and distribute tobacco taxes authorized by Section 21 of Article X of the State Constitution (Amendment 35), which was passed by the state's voters in the November 2004 general election. The same bill changed the financing for some existing tobacco education, prevention, and cessation programs from the Tobacco Litigation Settlement monies to the Tobacco Tax Cash monies. Both funds are reported in the state's Comprehensive Annual Financial Report in a single column titled Tobacco Impact Mitigation Fund. House Bill 05-1262 created several new funds to receive and expend monies distributed by the Tobacco Tax Cash Fund for programs generically designated in the constitution.

- House Bill 05-1330 authorized the Governor to initiate the sale and leaseback of eligible state facilities, in Fiscal Year 2005-06, if the Office of State Planning and Budgeting revenue estimates show that the required General Fund Reserve will drop below two percent. The State Capitol is not considered an eligible state facility.

Legislation that was passed and was contingent on a vote of the people at the November 1, 2005, general election included:

- House Bill 05-1194 placed a referred measure (Referendum C) on the statewide ballot requesting voter approval for the state to retain and spend all state revenues in excess of the constitutional revenue and spending limitations in Section 20 Article X of the State Constitution for the following five years. The legislation specified categories of spending that ranged from general to specific for the related spending. A companion measure (House Joint Resolution 05-1057 - Referendum D) that was contingent on the passage of Referendum C asked voters for authority to issue $2.072 billion of notes with a maximum repayment cost of $3.225 billion. The referendum specified that $1.7 billion would be issued for transportation needs while $147.0 million would be used to pay the settlement of a lawsuit that required the state to fund repairs of public school facilities. $50.0 million would be used to repair facilities at institutions of higher education, and $175.0 million would be used for state shortfalls in funding local fire and police pension liabilities. The voters passed Referendum C in the November 2005 election, and Referendum D was defeated.
- House Bill 05-1333 created the Critical Needs Financing Authority (CNFA) and authorized the Department of Transportation and the CNFA to issue notes authorized by Referendum D.

BUDGETARY AND OTHER CONTROL SYSTEMS

The General Assembly enacts the annual state budget for all ongoing programs, except for federal and custodial funds. New programs are funded for the first time in enabling legislation and are continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless extenuating circumstances prompt the State Controller to approve an appropriation rollforward. Capital construction appropriations are normally effective for three years.

The state records the budget in its accounting system along with estimates of federal awards and custodial funds of the various departments. Revenues and expenses/expenditures are accounted for on the basis used for the fund in which the budget is recorded except for certain budgetary basis exceptions (see Note RSI-1A). Encumbrances are also recorded and result in a reduction of the budgeted spending authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders, contracts, or other commitments are fulfilled. Encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for rollforward to the subsequent fiscal year. Fund balance is reserved for encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation’s portion of the Highway Users Tax Fund.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees against the risk of loss related to general liability, motor vehicle liability, and workers' compensation. Property claims are not self-insured, as the state has purchased insurance. The state uses the General Fund to account for the risk management function including operations and all matured claims or judgments. (See Note 6-H on page 77, Note 22 on page 103, Note 26 on page 110). Actuarially determined and other long-term risk management claims are reported only on the government-wide *Statement of Net Assets.* Medical claims for officials and employees are managed through the Group Benefits Plan Fund, a Pension and Employee Benefits Trust Fund. The Regents of the University of Colorado are self-insured for workers' compensation, auto, general, and property liability. The Board of Governors of the Colorado State University System is self-insured for certain risks and participates in the state's risk management fund for other risks.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 18 of this report. Besides auditing the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that federal moneys are used and accounted for properly. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the State Auditor's Statewide Single Audit Report. The State Auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CASH MANAGEMENT

Statutes permit the State Treasurer to invest cash that is not immediately needed to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The State Treasurer also invests funds of the Colorado Water Resources and Power Development Authority, a component unit, and the Great Outdoors Colorado Trust Fund, a related organization. Both are accounted for in the treasurer's agency funds. At June 30, 2005, the State Treasurer held the following investments at fair value:

Investment Type	Amount in Millions
U.S. Government Securities	$ 1,902.1
Commercial Paper	1,012.9
Asset Backed Securities	602.1
Corporate Bonds	468.8
Mutual Funds	50.0
Total	$ 4,035.9

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Colorado for its comprehensive annual financial report for the fiscal year ended June 30, 2004. This was the eighth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible. I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,

Leslie M. Shenefelt
State Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Colorado

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

Nancy L. Zielke
President

Jeffrey R. Esser
Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS