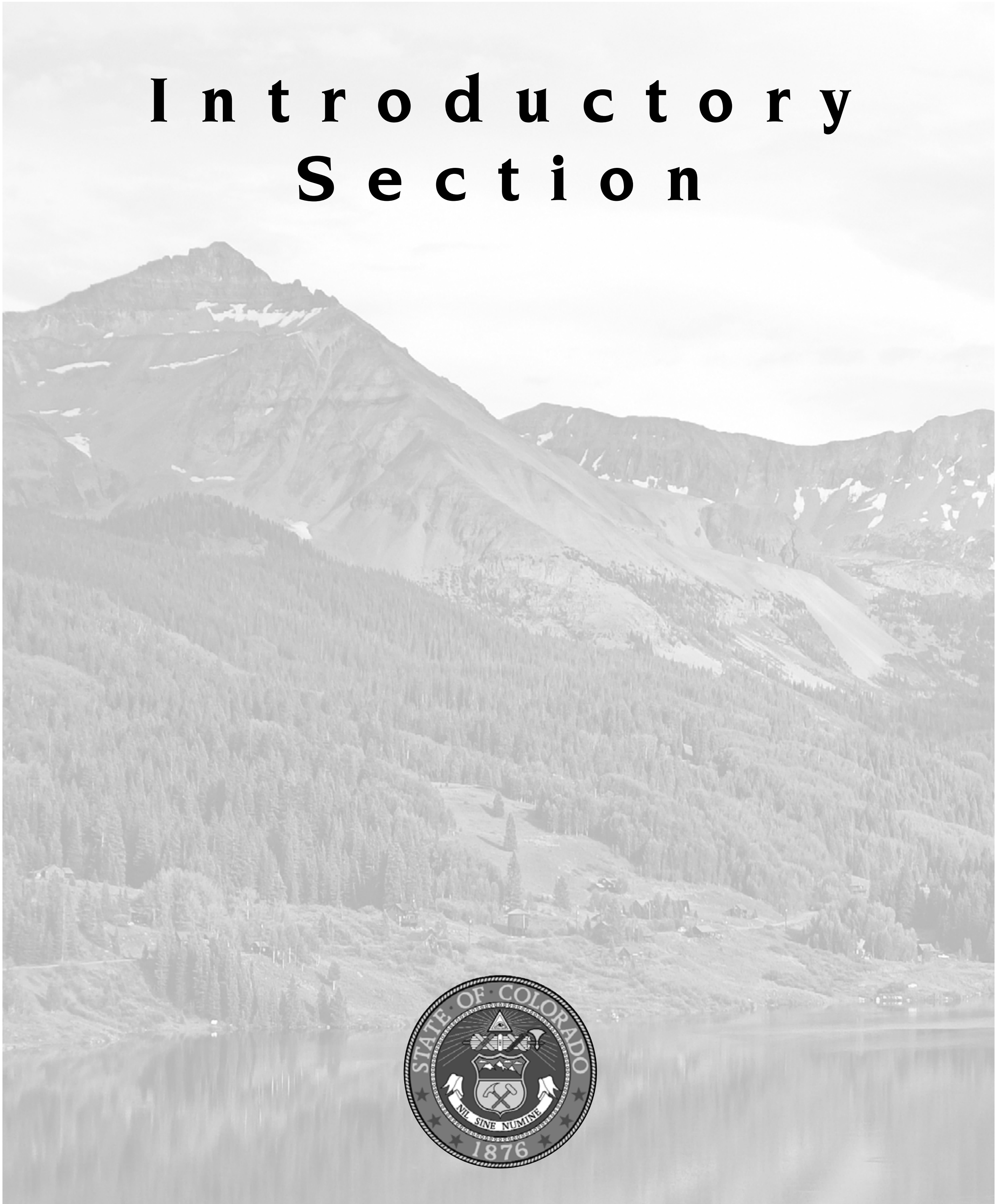
Introductory Section



Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2007

State of Colorado

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Governor

Rich Gonzales
Executive Director

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December 21, 2007

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, 2007. 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 presented to assist readers 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 governments 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 19, 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. (See additional information on "Cash Basis Accounting" on page 38 of the Management's Discussion and Analysis.) 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 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 qualify as 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
Venture Capital Authority

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 a limit on the number of terms allowed.

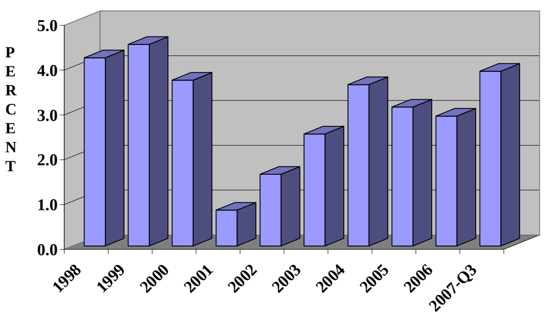
The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited 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 and submits 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 262 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 state's 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 revenues reflect the overall condition of the state economy, which showed a strong but declining rate of growth in Fiscal Year 2006-07; General Fund revenues increased by $567.0 million (8.4 percent) over the prior year. In absolute dollars, personal income in the state grew by 6.5 percent for 2006 and is forecast to grow by 6.2 percent for 2007. However, after adjustment for inflation and population growth, real per capita income growth was 1.0 percent for 2006 and is forecast to be 1.2 percent for 2007. The growth in new state employment also declined with 52,800 jobs added in 2006 and 36,300 forecast to be added in 2007.

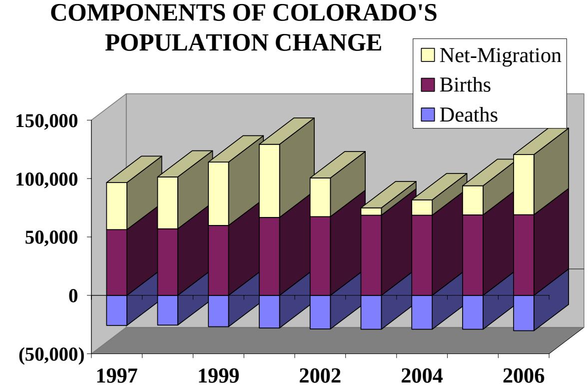
PERCENT CHANGE IN REAL GROSS DOMESTIC PRODUCT



Inflation adjusted national gross domestic product (GDP) grew at an annual rate of 2.9 percent in calendar year 2006 and at an estimated 3.9 percent in the third quarter of 2007. GDP grew 2.6 percent from the third quarter of 2006 to the third quarter of 2007 (all percentage changes in the balance of this paragraph are measured on the third quarter to third quarter basis). National personal consumption expenditures, which account for approximately two-thirds of GDP and were up 3.0 percent, outpaced the aggregate growth rate while private domestic investment (including nonresidential structures, equipment and software, residential, and changes in inventories) were down 4.5 percent. Residential investment declined 16.4 percent (sixth consecutive quarter of decline) offsetting a 12.8 percent increase in private investment related to nonresidential structures. Government spending exceeded the quarter-over-quarter growth rate at 2.7 percent largely related to a 5.6 percent increase in national defense expenditures offset by a decline in federal nondefense spending of 1.2 percent. Quarter-over-quarter export growth at 9.6 percent significantly exceeded import growth of 2.0 percent as the fall in the U.S. dollar makes our products less expensive on the world market.

The 16.4 percent decline in residential investment is an indicator of a generally depressed housing market. The housing market is in decline because of problems in the mortgage lending industry, which have limited the number of qualified buyers and reduced real estate values. Those problems are the result of lending policies during a period of low interest rates that allowed a large number of citizens to purchase homes with loans below market interest rates. These below market loans typically included provision such as interest only payments, adjustable interest rates, or balloon payments. As interest rates rose and home values fell, a large number of mortgages have gone into default nationwide. After a relatively short period during which interest rates were set close to historical averages, the Federal Reserve has had to again reduce short-term borrowing rates in an attempt to prevent the mortgage and residential building industry problems from adversely affecting the economy as a whole. The continued growth in personal consumption expenditures indicates that the problem has not yet spread to other sectors of the economy; however, the mortgage industry problems have been cited as partial cause for significant volatility in the stock market.

COMPONENTS OF COLORADO'S POPULATION CHANGE



Colorado economic activity and in-migration are interdependent, and the economic recovery in Fiscal Years 2005-06 and 2006-07 affected net in-migration in calendar year 2006. In-migration more than doubled from approximately 25,000 in 2005 to over 51,500 in 2006. It remains slightly off its peak amount of about 62,600, which occurred in 2001, but is significantly in excess of its low of about 6,300 in 2003. International in-migration increased slightly from approximately 20,300 to 21,600 for 2005 and 2006, respectively, however, in-migration from other states increased significantly from about 7,100 to about 29,800. The increase in migration from other states should benefit Colorado's economy as it likely represents an influx of more established households as compared to international in-migration. The information in the adjacent chart is based on current Census Bureau estimates, which were revised again during the past year. 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 reliable annual estimates for deaths and births are not available for that year.

The Governor's Office of State Planning and Budgeting (OSPB) predicts that Colorado's economy will maintain its current growth in the near term, and it has made the following forecast for Colorado's major economic variables:

- Employment will grow by 1.9 percent and 1.8 percent in 2007 and 2008, respectively.
- Unemployment will average 3.9 percent for 2007 compared with 4.3 percent and 5.1 percent in 2006 and 2005, respectively, and it is expected to stabilize in 2008 at 4.0 percent.
- Wages and salary income will grow by 6.0 percent in 2007 and 2008.
- Total personal income will increase by 6.2 percent in 2007.
- Net in-migration is expected to be 61,000 in 2007 and 65,500 in 2008 with total population growth of about 2.0 percent and 2.1 percent, respectively.
- Retail trade sales will increase 5.4 percent in 2007 and 6.4 percent in 2008.
- Colorado inflation will decline from 3.6 percent in 2006 to 2.8 percent in 2007 and 2.9 percent in 2008.

MAJOR GOVERNMENT FISCAL INITIATIVES

The General Assembly enacted and the Governor signed a large number of bills in the 2007 Legislative session. The main focus of the session from a programmatic perspective was on energy management, renewable energy, and health care. The 2007 legislative session marked the first time in several years in which the budget was prepared with both Referendum C in place and without a requirement to cut spending and/or identify alternative funding sources. However, because of the debt, tax, and revenue limitations in the State Constitution most of the legislation reallocated existing state revenues to different spending patterns rather than creating new revenue streams or new spending programs.

The General Assembly enacted the following measures that had financial management effects:

- In response to several years of deferred capital construction and capital maintenance, the General Assembly appropriated approximately $270 million for new construction and capital asset maintenance. These funds were available because of the absence of TABOR refunds, a relatively strong state economy, and the six percent limit on expenditure growth in the General Fund. Of the total capital appropriation from the General Fund, $30 million was made contingent on the adequacy of general-purpose revenues to maintain the maximum six percent general funded expenditure growth and the required four percent reserve.
- The state has historically backfilled local school districts revenue shortfalls resulting from decreases in the local property tax mill levy. Such mill levy decreases were often mandated by a combination of constitutional amendments unless school district voters authorized the district to keep revenues in excess of the constitutional limit. Even if voters authorized the retention of the excess revenues, the state's School Finance Act mandated reduction of the mill levy and required the state to backfill the revenue lost to the mill levy reduction. The Legislature passed a bill to remove this School Finance Act provision, and as a result, it was estimated that state public school expenditures would be $47.4 million lower in Fiscal Year 2007-08 than they would have been without this legislation. Opponents of the legislation contend that removing the mandated mill levy reduction is effectively an unauthorized tax increase.
- Several bills were passed to change existing annual allocations of certain resources:
    - The Joint Budget Committee is now required to propose legislation to apportion the Gaming Fund surplus between the General Fund and four separate cash funds when General Fund expenditure growth is expected to be less than the maximum allowable six percent.
    - Approximately $30 million of Tobacco Litigation Settlement monies will be diverted from the General Fund with about one half going to the University of Colorado at Denver and Health Sciences Center and the other half spread between certain existing and newly created health care funds.
    - The state is now authorized to spend the Tobacco Litigation Settlement monies in the year the monies are received rather than in the following year.

- A series of acts were passed regarding distribution and use of severance tax and mineral leasing revenues which increased significantly in Fiscal Year 2005-06 but decreased by 43 percent in Fiscal Year 2006-07.
- The existing diversion of General Fund sales and use tax revenue to the Older Coloradoans Fund was increased from $3.0 million annually to $5.0 million annually.

- One act required divestment of certain pension funds from securities of companies operating in Sudan to protest the genocide occurring in that country. The State Treasurer, the Public Employees Retirement Association (PERA), the state's Deferred Compensation Plan, and certain other pension organizations that are not part of the state's financial reporting entity were subject to the act. No provisions were made to address losses incurred related to the forced liquidation of the securities.
- Several measures were enacted that affect future payroll costs including revision of the salary cap for the highest paid state employees (with increases limited to the greater of the employment index change or the General Funded expenditure growth – not to exceed the salary survey increase), increase in legislator's per diem (increased to 85 percent of the federal per diem for Denver), 43 new judges added to the Judicial Branch over the period from Fiscal Year 2007-08 to 2009-10, and removal of the cap on the number of full-time-equivalent employees allowed at the Department of Transportation.

Several measures were enacted to establish renewable energy standards, promote the renewable and clean energy economy, and to manage renewable energy development, transmission, and consumption. Included among these provisions was a requirement for the State Architect to adopt a high performance standard certification program for state construction projects in order to reduce long-term operating costs, improve indoor environmental quality, and protect the local environment. Project plans where costs increase more than five percent to meet the standard must be reviewed and approved by the Legislature's Capital Development Committee. Another measure requires state agencies to award contracts for environmentally preferable products or services; such contract awards are not to exceed five percent additional cost.

A number of measures were added to address specific health care issues and access to health care by certain portions of the population. Included in these measures was the creation of the Start Smart Nutrition Program that specifies an annual appropriation between $0.7 and $1.5 million each year.

Within the fiscal year the media reported several failed or failing state computer systems. Some of those systems are currently functioning and some have been abandoned. One abandoned system resulted in an asset impairment that is reported in the attached financial statements as a special event. In response to concerns regarding accountability of state agencies for the contracting process and performance of vendors, the General Assembly enacted requirements for:

- A publicly searchable contracts management database,
- A limit on sole source personal service contracts,
- Agencies to evaluate and report on vendor performance in the contracts management database,
- Debarment of vendors for gross failure to meet contract performance measures,
- Default on an individual contract by a vendor to be considered default on all state contracts with that vendor, and
- Vendors to justify any contract work done outside of Colorado or the United States.

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 cause 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.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 16 of this report. Besides annually auditing the statewide financial statements, the auditor has the authority to audit the financial statements and operations of the 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.

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, 2006. This was the tenth 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 controllers, accountants, and program managers in the state departments and branches whose time and dedication have made this report possible. I reaffirm our commitment to maintaining the highest standards of accountability in financial reporting.

Sincerely,

Leslie M. Shenefelt

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, 2006

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.

President

Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS