

**PUBLIC EMPLOYEES' RETIREMENT
ASSOCIATION OF COLORADO**

Financial And Compliance Audit
Year Ended December 31, 2000

With Report Of Independent Accountants

To the participants and Board of Trustees of the
Public Employees' Retirement Association of Colorado
and the Legislative Audit Committee of the State of Colorado:

We have completed our audit of the general-purpose financial statements of the Public Employees' Retirement Association of Colorado ("PERA") as of and for the year ended December 31, 2000, and have issued an unqualified report thereon dated May 18, 2001. Our audit was conducted in accordance with auditing standards generally accepted in the United States.

We were engaged to conduct our audit pursuant to Section 24-51-204(6), C.R.S., which authorizes the State Auditor to conduct or cause to conduct audits of PERA. The accompanying Table of Contents sets forth the reports we have issued as part of our audit. Our audit opinion is located in the Comprehensive Annual Financial Report.

Denver, Colorado
May 18, 2001

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PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION OF COLORADO

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PUBLIC EMPLOYEES' RETIREMENT

ASSOCIATION OF COLORADO

DECEMBER 31, 2000

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PUBLIC EMPLOYEES' RETIREMENT

ASSOCIATION OF COLORADO

DECEMBER 31, 2000

Purpose And Scope

The scope of our work was to perform an audit of the financial statements of Public Employees' Retirement Association of Colorado ("PERA") for the year ended December 31, 2000. Our audit was conducted in accordance with auditing standards generally accepted in the United States.

In addition, the scope of the engagement included a report on the internal control structure based solely on an assessment of control risk made as part of the audit of the financial statements.

Summary of Major Audit Comments

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States

- Our audit was conducted in accordance with auditing standards generally accepted in the United States and was designed to provide reasonable, rather than absolute, assurance that the financial statements are free of material misstatement.
- We issued an unqualified opinion.

Accounting Policies

- We noted no new accounting policies were adopted for the year ended December 31, 2000.

Accounting for Estimates

- The preparation of financial statements require management to make estimates that affect the amounts reported in the financial statements and accompanying notes and supplementary schedules.

Significant estimates made by management include investments not traded on exchanges for which a quoted market price exists, the actuarial valuation of its assets and liabilities and certain self-insured liabilities of the Health Care Fund.

Unusual Transactions and Contingencies

- We noted no unusual transactions that have a material effect on the financial statements.
- We noted no material contingencies that were not disclosed in the financial statements.

Audit Adjustments

- We had one passed audit adjustment which does not have a material effect on the financial statements. The proposed adjustment was to reflect the increase in the value of investments in option contracts by appropriately \$30,488,900 due to the misidentification of one option contract in the determination of fair value at December 31, 2000.

Other Matters

- We noted no material errors or irregularities, or possible material illegal acts.
- We noted no material weaknesses in internal control.
- We had no disagreements with management on financial accounting and reporting matters and auditing procedures.
- We are not aware of any opinions obtained by management from other independent accountants.

ORGANIZATION AND FUNCTIONS OF PERA

The Public Employees' Retirement Association of Colorado ("PERA") was established in 1931 under Statute Title 24, Article 15 of the Colorado Revised Statutes. PERA administers cost-sharing multiple-employer defined benefit plans for the State and School Division Trust Fund, Municipal Division Trust Fund and Judicial Division Trust Fund. PERA also administers a cost-sharing multiple-employer defined benefit postemployment healthcare plan, the Insurance Dividend Reserve, and a multiple-employer Internal Revenue Code Section 401(k) defined contribution plan. The purpose of the Division Trust Funds is to provide benefits to members at retirement or disability, or to their beneficiaries in the event of death. Members of PERA are employed by public employers located in the State of Colorado and affiliated with PERA.

Responsibility for the organization and administration of the Division Trust Funds, Healthcare Trust Fund, Voluntary Investment Program and Insurance Dividend Reserve is placed with the Board of Trustees of PERA.

FINDINGS AND RECOMMENDATIONS

We have audited the financial statements of the Public Employees' Retirement Association of Colorado, ("PERA") for the year ended December 31, 2000, and have issued our report thereon dated May 18, 2001. In planning and performing our audit of the financial statements, we considered PERA's internal control solely to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. We have not considered internal control since May 18, 2001.

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

Recommendations noted in connection with the December 31, 2000 audit are detailed as follows:

Reconciliation of Option Contracts

As of December 31, 2000, PERA held option contracts with an estimated fair value of approximately \$480,234,000. Such contracts are utilized as hedges of certain investment securities. PERA utilizes Rampart Investment Management ("Rampart") to assist in tracking the option-related activity. Rampart is a third party that provides certain investment advisory services for PERA related to its hedging strategies. The option contract information is also maintained in the PERA's Investment management reporting system ("PORTIA"). The PORTIA system is a third party software system used by management to monitor the investment portfolio. Salomon Smith Barney, Inc. ("Salomon") is the administrator and overall custodian for the option contracts. The Northern Trust ("TNT") has control of all collateral related to the options contracts. All sources of information should be reconciled to ensure these investments are properly reflected in the general ledger. Subsequent to year-end it was noted by PERA that the reconciliation between information recorded by Rampart and the PORTIA system was not being performed in a timely manner. Furthermore, policy did not require the reconciliation of holdings to the Salomon custodian statements. As a result, certain contracts that were not properly valued, were not identified resulting in an understatement of the fair value of the investment portfolio at December 31, 2000 of approximately \$30,488,900.

PERA is responsible for designing and executing controls to mitigate the risk of misstatement. PERA has outsourced a substantial amount of those controls to Salomon in its capacity as custodian of the option contracts. PERA has retained responsibility for the execution of other controls designed to mitigate the risk of misstatement. These controls include reconciling the aggregate number of contracts included in the various reporting systems and monitoring the net investment performance in light of investment objectives and strategies, among others. In this case, the reconciliation controls failed due to execution error (i.e., reconciliation was not performed pursuant to policy).

In addition to the processes described above, the following controls should be considered to further mitigate the risk of misstatement.

Recommendation

- We recommend that PERA perform timely reconciliations of all critical data related to option contracts to the Salomon custodian statements.

- In addition to reconciling the aggregate number of contracts, we recommend that a periodic reconciliation of all key investment terms be performed, including number of contracts, ticker symbol, description, and fair value.
- We recommend that PERA evaluate existing technology used in various other reconciliation processes at PERA to determine whether the option contract reconciliation process can be automated.

Response

Recommendation 1

PERA's Investment Operations Division has begun a detailed monthly reconciliation of PORTIA back to Salomon on our covered call option program. We are now receiving an electronic file from Salomon (the custodian for our covered call options) on the 3rd business day of the month. PERA is currently downloading the information into an Excel worksheet, which compares the data to PORTIA. The reconciliation includes the number of contracts for each holding, the aggregate number of contracts for the portfolio, and the ticker symbol. Any exceptions are followed up on and the results are shared on a timely basis with PERA's Accounting Division and TNT. The reconciliation between TNT and PORTIA is also being continued as had been done in the past. This should insure the Salomon, TNT and PERA all have the same holdings.

Recommendation 2

PERA is now verifying the ticker symbol, number of contracts, cost and fair value with the various reconciliations, which we have put in place. The key in this process is the verification and reconciliation with our custodian Salomon as was described above. These reconciliations are done on a monthly basis and will be improved when this reconciliation moves to our automated reconciliation program.

Recommendation 3

PERA has begun evaluating and developing the ability to include the options data file from Salomon into our current automated reconciliation platform (used for equities and fixed income securities held at TNT) and the anticipated completion date is in the third quarter of 2001. Also, during this evaluation PERA is reviewing the pricing files used in the PORTIA system to improve the verification process on the fair value of these option contracts.

DISPOSITION OF RECOMMENDATIONS BY PRIOR AUDITORS

There were no recommendations from the 1999 audit, or any other unresolved issues from prior audits.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL CONTROL

To the Participants and Retirement Board of the
Public Employees' Retirement Association of Colorado and the
Legislative Audit Committee:

In planning and performing our audit of the financial statements of Public Employees' Retirement Association of Colorado for the year ended December 31, 2000, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control.

A material weakness is a significant deficiency in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

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

Denver, Colorado,
May 18, 2001.

DISTRIBUTION

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Legislative Audit Committee (12)

Public Employees' Retirement Association of Colorado (30)

Joint Budget Committee (2)

Department of Treasury (2)

Department of Personnel
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Executive Director (2)
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