PINNACOL ASSURANCE

Statutory Financial Statements and
Other Financial Information and
Comments on Internal Controls and Procedures

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

April 7, 2006

Members of the Legislative Audit Committee and
the Pinnacol Assurance Board of Directors:

We have completed the financial audit of Pinnacol Assurance (Pinnacol) for the year ended December 31, 2005. Our audit was conducted in accordance with auditing standards generally accepted in the United States of America. We were engaged to conduct our audit pursuant to Section 8-45-121(2), C.R.S., which authorizes an annual audit of Pinnacol made by an auditor or firm of auditors, having the specialized knowledge and experience, retained by the state auditor with the consultation and advice of the chief executive officer and the commissioner of insurance. The reports which we have issued as a result of this engagement are set forth in the table of contents which follows.

KPMG LLP

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PINNACOL ASSURANCE

Statutory Financial Statements and
Other Financial Information and
Comments on Internal Controls and Procedures

Years ended December 31, 2005 and 2004

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PINNACOL ASSURANCE

Report Summary

Authority and Purpose/Scope of the Audit

This audit was conducted under the authority of Section 8-45-121(2), C.R.S., which authorizes an annual audit of Pinnacol Assurance made by an auditor or firm of auditors, having the specialized knowledge and experience, retained by the state auditor with the consultation and advice of Pinnacol's chief executive officer and the commissioner of insurance. The primary purpose of our engagement was to audit the statutory financial statements of Pinnacol at December 31, 2005, and for the year then ended, in accordance with auditing standards generally accepted in the United States of America and to express an opinion on those financial statements and the notes thereto. The objective of an audit conducted in accordance with such standards is to obtain reasonable, but not absolute, assurance about whether the statutory financial statements are free of material misstatement.

The financial statements of Pinnacol were prepared in accordance with statutory accounting principles prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (hereinafter referred to as statutory financial statements, or in accordance with statutory accounting principles). Accordingly, they are not designed to present, and do not present, the financial position or results of operations in accordance with accounting principles generally accepted in the United States of America.

We examined, on a test basis, evidence supporting the amounts and disclosures in Pinnacol's financial statements as of December 31, 2005. The accounting practices used by Pinnacol to prepare the financial statements are in conformity with accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (the Division).

Required Communications to the Legislative Audit Committee

In accordance with auditing standards generally accepted in the United States of America (AU Section 380), and the Statement of Auditing Standards (SAS) No. 61, *Communication with Audit Committees*, as amended, we must communicate to the audit committee certain matters noted during our audit. The following sets forth these required communications:

1. **Auditor's Responsibility Under Professional Standards** – We have a responsibility to conduct our audit of the financial statements in accordance with professional standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

   In addition, in planning and performing our audit of the financial statements, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit of the financial statements does not include examining the effectiveness of internal control and does not provide assurance on internal control.

2. **Significant Accounting Policies and Alternative Treatments** – The significant accounting policies used by Pinnacol are described in note 1 to the financial statements. There were no changes to significant accounting policies in 2005.

3. **Management Judgments and Accounting Estimates** – The preparation of the financial statements requires management of Pinnacol to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. We have reviewed, as part of our normal audit procedures, information regarding management's formulation of accounting estimates and have concluded that the estimates are reasonable in the context of the financial statements taken as a whole. The major accounting estimates are as follows:

   Uncollected Premiums – The amount of uncollected premiums, which affects the amount of premium revenue recognized, is estimated using statutory requirements as well as certain management judgments. Management must determine whether an allowance should be established to provide for all reasonably anticipated uncollectible amounts inherent in the uncollected premiums balance. Factors which are considered in establishing reserves for anticipated uncollectible amounts are collection experience and trends, current overall aging of balances, economic conditions and trends, and evaluations of individual accounts. At December 31, 2005, the admitted value of uncollected premiums is estimated to be $57,985,000.

   Earned but Unbilled Premiums Receivable – Pinnacol estimates audit premium adjustments based on prior experience. This prior experience provides actual collection activity which is then used in establishing estimated premium revenue in the current period related to audit adjustments, subject to current influences such as inflation and other factors. For 2005, estimated net unbilled audit premiums receivable of $13,587,000 are included in uncollected premiums.

   Unpaid Losses and Loss Adjustment Expenses – Estimating unpaid losses and loss adjustment expenses (reserves) of an insurance company is a subjective and judgmental process, particularly for workers' compensation insurance, where the ultimate liability to a claimant may not be known with certainty for a number of years. To assist management in estimating the liability for unpaid losses and loss adjustment expenses, Pinnacol retains the actuarial consulting services of Milliman U.S.A. At December 31, 2005, Pinnacol has accrued $1,205,693,000 for unpaid losses and loss adjustment expenses as management's best estimate, which management believes to be a reasonable estimate of future amounts to be paid for claims incurred in 2005 or prior. Pinnacol discounts certain unpaid losses on a tabular basis using a discount rate of 3.5% in 2005 and 2004. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. State law allows Pinnacol the use of a discount factor of up to 6.00%. As approved by the Division and in accordance with the Division's interpretation of the surplus recovery plan filed with the Division in a prior year, Pinnacol discounted its actuarially determined unpaid balances on a non-tabular basis by a factor of 3.75% as of and for the year ended December 31, 2003. As of December 31, 2003, Pinnacol achieved its goal of attaining an acceptable level of surplus as outlined in the surplus recovery plan. Therefore, Pinnacol was no longer permitted to discount actuarially determined balances as of and for the year ended December 31, 2004, and the nontabular discount was eliminated as of March 31, 2004 in accordance with the surplus recovery plan.

4. **Audit Adjustments and Uncorrected Misstatements** – The statutory financial statements incorporated herein contain no differences with Pinnacol's Annual Statement as filed with the Division for the year ended December 31, 2005. In connection with our audit of the Company's financial statements, we have discussed with management a certain financial statement misstatement that has not been corrected in the

(Continued)

Company's books and records as of and for the year ended December 31, 2005. This misstatement relates to a billing error which resulted in a proposed entry to increase receivables by approximately $542,000 and to increase third-party claims recoveries in the statement of operations by $345,000 and to increase prior year policyholders' surplus by $197,000. We have reported this misstatement to management on a Summary of Uncorrected Misstatements and have received written representations from management that management believes that the effects of the uncorrected financial statement misstatements are immaterial, both individually and in the aggregate, to the statutory financial statements taken as a whole.

5. **Other Information in Documents Containing Audited Financial Statements** – Our responsibility for other information in documents containing the Company's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents.

6. **Disagreements With Management** – There were no disagreements with management on financial accounting or reporting matters that, if not satisfactorily resolved, would have caused a modification of our auditors' report on the Company's financial statements.

7. **Difficulties Encountered in Performing the Audit** – We encountered no significant difficulties in dealing with management in performing our audit.

8. **Independence** – Our professional standards and other regulatory requirements specify that we communicate to you in writing, at least annually, all independence-related relationships between our firm and Pinnacol and provide confirmation that we are independent accountants with respect to Pinnacol.

   We hereby confirm that as of April 7, 2006, we are independent accountants with respect to Pinnacol under all relevant professional and regulatory standards.

9. **Other Matters** – KPMG performed this audit under contract with the Office of the State Auditor and does not discuss accounting or auditing issues with management in connection with our initial or recurring retention as auditor.

Summary of Major Audit Findings

Information Technology General Controls

Internal control over information technology is important as it is a component of internal control over financial reporting. Pinnacol's information technology general controls for setting network passwords, creating user identifications, and defining system access were not always adequate.

Authorization of Journal Entries

Managers in the finance department have access to both create and release journal entries in the system. There is a policy in place that all journal entries created and released by the same individual and exceeding $50,000 must be signed by the Chief Financial Officer. However, this policy does not mitigate the risk that intentional or unintentional misstatements under $50,000 could occur. No material misstatements were identified during the audit.

PINNACOL ASSURANCE

Report Summary

Summary of Pinnacol's Responses

A summary of the recommendations for the above comments is included in the Recommendation Locator on the next page. The Recommendation Locator also shows Pinnacol's response to the audit recommendations. A discussion of the audit comments and recommendations is contained in the Findings and Recommendations Section of our report.

Summary of Progress in Implementing Prior Audit Recommendations

The disposition of prior audit recommendations as of April 7, 2006, was:

Implemented	1
Partially implemented	—
Not implemented	—
	1

Disposition of Prior Audit Recommendations

The audit report for the year ended December 31, 2004, included one recommendation. The disposition of this audit recommendation is as follows:

Recommendation	Disposition
1. Pinnacol should enhance its investment management process by enhancing documented policies and procedures for administering and recording investment transactions and improving management review procedures.	Implemented.

PINNACOL ASSURANCE

Recommendation Locator

December 31, 2005

Recommendation locator

Recommendation number	Page number	Recommendation summary	Pinnacol response	Implementation date
1	8	Pinnacol should enhance its information technology general controls by expanding control processes related to network passwords, user IDs, and system access by aligning them with documented policies and procedures and ensuring that regular reviews of such processes are performed.	Agree.	1st quarter 2006
2	9	Pinnacol should enhance its controls over the authorization of journal entries by implementing mitigating controls to ensure that intentional or unintentional misstatements that could occur as a result of journal entries being created and posted by the same user do not go undetected.	Agree.	1st quarter 2006

PINNACOL ASSURANCE

Description of Pinnacol Assurance

December 31, 2005

Pinnacol Assurance was established under provisions of the Workers' Compensation Act of Colorado (Title 8, Article 45 of the Colorado Revised Statutes, as amended) for the benefit of injured employees and dependents of deceased employees in Colorado. As required under state law, Pinnacol provides an assured source of workers' compensation insurance to Colorado employers. Pinnacol shall not refuse to insure any Colorado employer or cancel any insurance policy due to the risk of loss or amount of premium, except as otherwise provided in Title 8, Article 45, C.R.S., as amended.

As of July 1, 2002, Pinnacol Assurance's name was officially changed from Colorado Compensation Insurance Authority to Pinnacol Assurance (Pinnacol).

Pinnacol is controlled by a nine-member board of directors, which is appointed by the governor with the consent of the senate. The board of directors appoints a chief executive officer. This is in accordance with the applicable statutes of the state, with administration under the direction of a chief executive officer. The state retains no liability on the part of Pinnacol, beyond the amount of any Pinnacol surplus, and no state monies are used for Pinnacol operations. Under Title 8, Article 45, C.R.S., as amended, the state treasurer was the custodian for Pinnacol's cash and invested assets, and after consulting with Pinnacol, the state treasurer made all investing decisions until November 30, 2004. As of November 30, 2004, the custody of Pinnacol's cash and invested assets and all investment-related functions were transferred to the board of directors of Pinnacol.

In 2005, Pinnacol paid over $55 million in general policyholder dividends to its policyholders in good standing. This is included in Dividends to Policyholders on the Statutory Statement of Income and Changes in Policyholders' Surplus and reduces net income for the year ending December 31, 2005. This accounting treatment is in accordance with statutory accounting practices. See further information at note 1 (n), General Policyholder Dividends.

Policyholders' Surplus

Pinnacol had policyholders' surplus of $471,849,000 and $365,794,000 as of December 31, 2005 and 2004, respectively. The increase in surplus is primarily related to current-year net income.

In response to Section 8-45-111, C.R.S., management of Pinnacol developed, filed, and received approval effective January 1, 2001, of a long range plan (the Plan) to strengthen its financial position and attain "a reasonable policyholders' surplus." The Plan called for Pinnacol to achieve the "company action level of risk-based capital." Pinnacol has achieved its goal of attaining an acceptable level of surplus as outlined in the state statutes. Pinnacol's surplus level as of December 31, 2003, was verified through an examination conducted by the Division that was completed on November 8, 2004.

Note 7 expands on the information detailed above, including the definitions attributable to risk-based capital.

Information Technology General Controls

Although the provisions of the federal Sarbanes-Oxley Act, Section 404, have not yet directly affected non-public insurance companies, there is a heightened awareness among the industry of the importance of the internal control structure. The NAIC/AICPA Working Group has proposed to incorporate selected Sarbanes-Oxley type provisions in the model audit rule, including the provision that insurance companies with $500 million or more in direct written and assumed premium will be required to file a report annually on their assessment of internal control over financial reporting effective beginning with the reporting period ending December 31, 2009, with the first report due in 2010, 60 days after filing the 2009 annual audited financial report. As a result, enhancements to internal controls, including information technology general controls, are becoming common throughout the industry. Internal control over information technology is important as it is a component of internal control over financial reporting. Pinnacol had approximately 555 employees as of December 31, 2005. Pinnacol's primary information system is the Workers' Compensation Information System (WCIS). Other systems include Human Resources Perspective, Clear Warrant Viewer, Payformance, the Lawson general ledger system, the Automatic Data Processing (ADP) system for payroll, and the Oracle database. Most employees have access to certain applications within WCIS; however, other systems may only be accessed by a limited number of employees.

During a review of a selection of Pinnacol's information technology general controls, we noted the following:

- Network password settings are generally set for five characters. However, Pinnacol's Information Systems Security Policy requires a minimum of eight characters for users and a minimum of ten characters for administrators. The greater the amount of characters required in a password, the less likely it is that unauthorized users could obtain passwords and access the network.
- Shared user identifications (IDs) are utilized in the Oracle database. Six Oracle database administrators share the same IDs and passwords. As a result, changes to Oracle cannot be traced to a specific administrator for follow-up. Conversely, with respect to the ADP system used for payroll processing, the administrator has multiple user IDs, which could result in a lack of segregation of duties.
- Users must have a unique user ID and a personal password for access to multi-user computers and computer networks; however, four generic user IDs were found in the premiums module of WCIS.
- For employee promotions/job transfers, system administrators run a check to compare the access rights for that employee to another employee with the same job code to ensure the correct access has been granted. During our review, a junior underwriter was compared to a senior underwriter, but the comparison yielded no results, which would indicate that the junior and senior underwriters have the same access privileges. Senior underwriters have different approval levels than junior underwriters. If a junior underwriter had the same access as a senior underwriter, they could potentially access information not necessary for an employee with that level of experience.
- Four users had access to update premiums screens within WCIS, which appeared inappropriate because the users did not have the appropriate level of experience to do so. Similarly, certain job codes within WCIS do not appear to align with the respective job functions/responsibilities, resulting in unnecessary access for some users. Though it does not appear that any unauthorized changes were made as a result, such access could give rise to errors or misstatements.

Recommendation No. 1

Pinnacol should enhance its information technology general controls by expanding control processes related to network passwords, user IDs, and system access by aligning them with documented policies and procedures and ensuring that regular reviews of such processes are performed.

a. Pinnacol should ensure that all passwords require a minimum of eight characters in accordance with policies.

b. Each employee should be assigned one user ID that is specific to him or her for a respective application. Changes made by system administrators should be regularly reviewed by management.

c. User access privileges should be reviewed regularly for reasonableness with respect to job positions/responsibilities.

Pinnacol Response:

Agree. The suggested control enhancements have been implemented.

Authorization of Journal Entries

Journal entries are created by staff accountants in the finance department. Those entries must then be approved and released in the system by a manager, as the staff accountants do not have access to release the entries in the system. Managers, however, have access to both create and release journal entries in the system. There is a policy in place that all journal entries created and released by the same individual and exceeding $50,000 must be signed by the Chief Financial Officer (CFO). However, this policy does not mitigate the risk that intentional or unintentional misstatements under $50,000 could occur. No material misstatements were identified during the audit.

Recommendation No. 2

Pinnacol should enhance its controls over the authorization of journal entries by implementing mitigating controls to ensure that intentional or unintentional misstatements that could occur as a result of journal entries being created and posted by the same user do not go undetected. Pinnacol should consider altering the system access of the managers to enable them only to release journal entries as opposed to creating them as well, or requiring that all journal entries created and released by the same individuals are properly authorized by management.

Pinnacol Response:

Agree. All journal entries entered and released by the same individual will be authorized in writing by management.

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

Independent Auditors' Report

Members of the Legislative Audit Committee and
the Pinnacol Assurance Board of Directors:

We have audited the accompanying statutory statements of admitted assets, liabilities, and policyholders' surplus of Pinnacol Assurance (the Company) as of December 31, 2005 and 2004, and the related statutory statements of income and changes in policyholders' surplus and cash flows for the years then ended. These statutory financial statements are the responsibility of the Company'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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 described more fully in note 1 to the statutory financial statements, the Company prepared these financial statements in conformity with accounting practices prescribed or permitted by the Division of Insurance of the Department of Regulatory Agencies of the State of Colorado (the Division), which practices differ from U.S. generally accepted accounting principles. The effects on the financial statements of the variances between such practices and U.S. generally accepted accounting principles also are described in note 1.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Pinnacol Assurance as of December 31, 2005 and 2004, or the results of its operations or its cash flows for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and policyholders' surplus of Pinnacol Assurance as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Division.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on the supplemental schedules of investment information 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 audits 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.

KPMG LLP

April 7, 2006

PINNACOL ASSURANCE

Statutory Statements of Admitted Assets, Liabilities, and Policyholders' Surplus

December 31, 2005 and 2004

(In thousands)

Admitted Assets		2005	2004
Cash and invested assets:			
Bonds at amortized cost, fair value of $1,549,582 in 2005 and $1,346,325 in 2004 (note 3)	$	1,536,708	1,292,728
Common stock at fair value, cost of $140,634 in 2005 and $127,372 in 2004 (note 3)		159,751	140,699
Real estate at cost, net of accumulated depreciation		22,885	23,702
Cash and cash equivalents		20,954	142,925
Other invested assets		13,560	13,560
Total cash and invested assets		1,753,858	1,613,614
Uncollected premiums, net		57,985	45,578
Electronic data processing equipment, at cost, net of accumulated depreciation of $3,898 and $3,239 in 2005 and 2004, respectively		992	946
Accrued investment income		15,514	13,079
Total admitted assets	$	1,828,349	1,673,217
Liabilities and Policyholders' Surplus			
Liabilities:			
Reserve for unpaid losses and allocated loss adjustment expenses (note 2)	$	1,167,693	1,121,874
Reserve for unpaid unallocated loss adjustment expenses (note 2)		38,000	37,000
Total reserve for unpaid losses and loss adjustment expenses		1,205,693	1,158,874
Other liabilities		35,793	34,098
Unearned premiums		95,107	95,765
Dividends payable to policyholders		10,046	7,840
Credit balances due policyholders		9,861	10,846
Total liabilities		1,356,500	1,307,423
Commitments and contingencies (notes 2, 6, and 9)			
Policyholders' surplus (note 7)		471,849	365,794
Total liabilities and policyholders' surplus	$	1,828,349	1,673,217

See accompanying notes to statutory financial statements.

PINNACOL ASSURANCE

Statutory Statements of Income and Changes in Policyholders' Surplus

Years ended December 31, 2005 and 2004

(In thousands)

		2005	2004
Underwriting income:			
Premiums earned (note 6)	$	566,470	515,471
Deductions:			
Losses incurred (note 2)		364,274	442,213
Loss adjustment expenses incurred (note 2)		24,021	29,151
Other underwriting expenses incurred		101,818	100,738
Total underwriting deductions		490,113	572,102
Net underwriting gain (loss)		76,357	(56,631)
Investment income:			
Net investment income earned		85,600	80,472
Net realized capital gain		3,508	23,331
Net investment income		89,108	103,803
Other income (loss):			
Provision for uncollectible premiums		(2,362)	(2,245)
Other income		2,683	2,656
Dividends to policyholders		(62,290)	(8,573)
Net income		103,496	39,010
Change in nonadmitted assets (increase)/decrease		(924)	662
Change in net unrealized gain/(loss) in investments		3,483	(1,176)
Policyholders' surplus at beginning of year		365,794	327,298
Policyholders' surplus at end of year	$	471,849	365,794

See accompanying notes to statutory financial statements.

PINNACOL ASSURANCE

Statutory Statements of Cash Flows

Years ended December 31, 2005 and 2004

(In thousands)

		2005	2004
Cash flows from operations:			
Premiums collected, net of reinsurance	$	553,405	521,116
Losses and loss adjustment expenses paid, net		(341,476)	(336,918)
Underwriting expenses paid		(98,902)	(95,235)
Dividends paid to policyholders		(62,290)	(8,573)
Cash from underwriting		50,737	80,390
Net investment income		80,259	76,805
Net amount withheld or retained for account of others		321	411
Net cash provided by operations		131,317	157,606
Cash flows from investments:			
Proceeds from sale or redemption of investments		167,639	393,795
Purchase of investments		(417,494)	(503,667)
Net cash used for investments		(249,855)	(109,872)
Cash flows from financing and miscellaneous sources:			
Cash used by other miscellaneous sources		(3,433)	(2,900)
Net cash used for financing and miscellaneous sources		(3,433)	(2,900)
Increase (decrease) in cash on hand and on deposit		(121,971)	44,834
Cash on hand and on deposit, beginning of year		142,925	98,091
Cash on hand and on deposit, end of year	$	20,954	142,925

See accompanying notes to statutory financial statements.

(1) Nature of Operations and Significant Accounting Policies

(a) Organization

Pinnacol Assurance (Pinnacol) was established under provisions of the Workers' Compensation Act of Colorado (Title 8, Article 45 of the Colorado Revised Statutes (C.R.S.), as amended) for the benefit of injured employees and dependents of deceased employees. Pinnacol provides insurance to employers operating within the state of Colorado (the State) not otherwise insured through private carriers or self-insurance.

Pinnacol is controlled by a nine-member board of directors, which is appointed by the governor, with the consent of the senate. In accordance with the applicable statutes of the state, the administration of Pinnacol is under the direction of a president, appointed by the board of directors. The State retains no liability on behalf of Pinnacol, and no state monies are used for Pinnacol operations.

Pinnacol achieved its goal of attaining an acceptable level of surplus as outlined in the state statutes. Pinnacol's surplus level as of December 31, 2003, was verified through an examination conducted by the Colorado Division of Insurance (the Division) that was completed on November 8, 2004. Under the applicable statutes, the state treasurer was the custodian for Pinnacol's cash and invested assets until November 30, 2004, when the custody of cash and invested assets was transferred to the board of directors of Pinnacol. With the attainment of an acceptable level of surplus, Pinnacol's board of directors assumed control of the investment portfolio and all investment-related functions previously handled by the state treasurer. In addition, Pinnacol is no longer subject to the provisions of the Government Immunity Act.

As Pinnacol has attained an acceptable level of surplus in 2004, Pinnacol paid over $55 million in general policyholder dividends to its policyholders in good standing. An acceptable level of surplus is that which exceeds the Company action level of risk-based capital, which is $141,404,000 for 2005. The board of directors, at its discretion, will determine the amount of policyholder dividends to be declared based on Pinnacol's overall experience and financial condition. This is the first time Pinnacol has paid a general dividend in 23 years. See further information at note 1 (n), General Policyholder Dividends.

(b) Basis of Presentation

The accompanying financial statements of Pinnacol have been prepared in accordance with accounting practices prescribed or permitted by the Division. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference to state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Colorado has adopted the National Association of Insurance Commissioners' (NAIC) statutory accounting practices, which are codified in the NAIC's Accounting Practices and Procedures Manual (the Manual). Therefore, compliance with the Manual is a prescribed accounting practice.

Statutory accounting practices contained in the Manual vary in some respects from accounting principles generally accepted in the United States of America (GAAP). The more significant statutory practices include:

Investments: Investments in bonds and mandatorily redeemable preferred stocks are reported at amortized cost or market value based on their NAIC rating; for GAAP, such fixed maturity investments would be reported at fair value with unrealized holding gains and losses reported in operations. Real estate owned and occupied by Pinnacol is included in investments rather than reported as a capital asset as under GAAP.

Policy Acquisition Costs: The costs of acquiring and renewing business are expensed when incurred. Under GAAP, such costs, to the extent recoverable, would be deferred and amortized over the effective period of the related insurance policies.

Nonadmitted Assets: Certain assets designated as “nonadmitted,” principally past due premiums receivable, furniture and equipment, and other assets not specifically identified as an admitted asset within the Manual, are excluded from the accompanying balance sheets and are charged directly to policyholders’ surplus. Under GAAP, such assets are included in the balance sheets at their net realizable value.

The effects of the foregoing variances from GAAP on the statutory financial statements at December 31, 2005 and 2004, and for the years then ended have been determined and are presented below:

		December 31	
		2005	2004
		(In thousands)	
Statutory policyholders’ surplus	$	471,849	365,794
Nonadmitted assets		10,761	9,836
Policy acquisition costs, net of amortization		8,409	8,812
Net unrealized gains on bonds		12,874	53,597
GAAP net assets	$	503,893	438,039
Statutory net income	$	103,496	39,010
Policy acquisition costs, net of amortization		(403)	5,501
Change in fair value of investments		(37,239)	(10,291)
GAAP changes in net assets	$	65,854	34,220

(c) Use of Estimates

The preparation of statutory financial statements in accordance with accounting practices prescribed by the Division requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates include the reserves for unpaid losses and loss adjustment expenses and the earned but unbilled premiums receivable balance included in uncollected premiums among others. Unpaid losses and loss adjustment expense reserves represent estimates of the ultimate unpaid cost, net of reinsurance, of all losses incurred, including losses incurred but not reported. The liability is an estimate and, as such, the ultimate actual liability may vary from the recorded amounts. The liabilities are reviewed periodically, and adjustments to the reserve are included in operations. Actual results could differ from those estimates, and such differences could be significant.

(d) Investments

Investments are recorded on the trade date and are carried in accordance with the valuations prescribed by the Committee on Valuation of Securities of the NAIC. Bonds are stated at amortized cost and are adjusted for other than temporary declines in fair value. Stocks are carried at estimated statutory fair value and are adjusted for other than temporary declines in fair value. Changes in fair values of stocks and equity funds are reported as unrealized capital gains (losses) by a direct adjustment to unassigned surplus.

Amortization of bond premium or discount is calculated using the interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions are amortized to the call or maturity value or date that produces the lowest asset value.

Gains and losses on investments sold are realized in operations and are computed using the specific identification method.

Prepayment assumptions for purposes of recognition of income and valuing of loan-backed bonds and structured securities were obtained from external broker dealer survey values or internal estimates. These assumptions are consistent with the current interest rate and economic environment. The prospective method is used to value mortgage-backed securities in 2005, while the retrospective method was used in 2004. Pinnacol does not believe there is any significant adjustment necessary at December 31, 2005 or 2004 under the methods or due to the change in methods, as the impact is deemed to be minimal. Pinnacol elected to use the book value as of January 1, 1994, as the cost for applying the retrospective method in 2004 to securities purchased prior to that date. Prepayment assumptions for single-class and multi-class mortgage-backed/asset-backed securities were obtained from Yield Book and Bloomberg.

Real estate includes land, the building on the land, and capitalized building improvements used in conducting the Company’s business. Land is carried at cost. Building and capitalized building improvements are carried at cost less allowances for depreciation. The cost of the building and capitalized improvements is depreciated over an estimated useful life of 30 years using the straight-line method. Depreciation expense was $821,000 and $816,000 for the years ended December 31, 2005 and 2004, respectively.

(e) Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents include cash on deposit, money market funds, and other investments with maturities of three months or less at the date of acquisition.

As of December 31, 2005, cash and cash equivalents of $20,954,000 include $10,242,000 of cash, $4,987,000 of cash equivalents, and $5,725,000 of short-term investments in bonds. As of December 31, 2004, cash and cash equivalents of $142,925,000 include $8,303,000 of cash, $79,883,000 of cash equivalents, and $54,739,000 of short-term investments in bonds. In the accompanying statutory balance sheets, Pinnacol has recorded checks that have been issued, but not presented for payment, as a reduction of cash and cash equivalents. Also included in cash and cash equivalents are amounts held as collateral for assumptive reinsurance agreements of $4,836,000 and $1,557,000 as of December 31, 2005 and 2004, respectively.

(f) Other Invested Assets

Other invested assets of $13,560,000 as of December 31, 2005 are long-term investments in U.S. Treasury notes that are held as collateral for assumptive reinsurance agreements and are stated at amortized cost.

(g) Uncollected Premiums

Uncollected premiums are reported net of allowances for uncollectible and nonadmitted balances. Certain receivables are not admissible for statutory accounting purposes.

Receivables for canceled policies and billed receivables that have been outstanding for a period exceeding 90 days are not admissible according to the Manual. Pinnacol independently estimates the realizable amounts of premiums receivable and nonadmits uncollectible premiums for the difference between the gross receivable amount and the estimate of the amount to be ultimately realized. Pinnacol also nonadmits receivables for the amount by which nonadmissible receivables, as defined above, exceed the estimate of uncollectible receivables.

During 2005 and 2004, Pinnacol recorded a provision, net of recoveries, or wrote off a total of $2,362,000 and $2,245,000, respectively, in premiums receivable due to the unlikelihood of ultimate collection thereof. These amounts are reflected as provision for uncollectible premiums in the accompanying financial statements.

A significant portion of Pinnacol’s premiums receivable balances at December 31, 2005 and 2004 were from companies operating in the construction and services industries in Colorado. The construction industry represents 39% and 38% of premiums receivable balances as of December 31, 2005 and 2004, respectively. The services industry represents 22% and 24% of premiums receivable balances as of December 31, 2005 and 2004, respectively, with all other individual industries constituting the remainder of premiums receivable balances.

(h) Earned but Unbilled Premiums

Earned but unbilled premiums represent audit premiums, which are amounts due from policyholders after the respective policy period has expired based on audits performed by Pinnacol. Such amounts are estimated by Pinnacol using internal statistically supported aggregate calculations using historical unearned premium data and per policy calculations. For 2005 and 2004, estimated unbilled audit premiums receivable of $13,587,000 and $5,738,000, respectively, are included as uncollected premiums. These estimated receivables have been reduced by 10%, where applicable, to comply with the Manual.

(i) Retrospectively Rated Contracts

Pinnacol estimates accrued retrospective premium adjustments through the review of each individual retrospectively rated risk, comparing case basis loss development with that anticipated in the policy contract to arrive at the best estimate of return or additional retrospective premium. Pinnacol records accrued retrospective premium as an adjustment to earned premium. Net premiums earned on retrospective workers' compensation policies were $2,068,000 and $1,762,000 in 2005 and 2004, respectively. These amounts represent 0.4% and 0.5% of total net premiums written as of 2005 and 2004, respectively. Ten percent of the amount of accrued retrospective premiums not offset by collateral has been nonadmitted. The total admitted amount of retrospective premium is as follows:

		December 31	
		2005	2004
		(In thousands)	
Secured accrued retrospective premium	$	2,342	2,114
Unsecured amount		—	59
Less nonadmitted amount (10%)		—	(6)
Admitted amount	$	2,342	2,167

(j) Credit Balances Due Policyholders

Credit balances due policyholders represent excess premiums, which are amounts due to policyholders after the respective policy period has expired based on audits performed by Pinnacol. Such amounts are based on actual results. Generally, credit balances due policyholders are applied to future premium obligations of policyholders. For 2005 and 2004, such amounts are approximately $9,861,000 and $10,846,000, respectively.

(k) Electronic Data Processing Equipment

Electronic data processing equipment is recorded at cost, less accumulated depreciation, and depreciated on a straight-line basis over an estimated useful life of three years. Net book value of these assets at December 31, 2005 and 2004 was $992,000 and $946,000, respectively. Related depreciation expense of $659,000 and $1,166,000 was incurred during 2005 and 2004, respectively.

(l) Office Furniture and Equipment

Office furniture and equipment and art are recorded at cost and depreciated on a straight-line basis over an estimated useful life of five years. In accordance with the Manual, these are nonadmitted assets. The net book value of these assets at December 31, 2005 and 2004 was $3,236,000 and $3,630,000, respectively. Related depreciation expense of $696,000 and $791,000 was incurred in 2005 and 2004, respectively.

(m) Other Assets

At December 31, 2005 and 2004, Pinnacol had prepaid assets and deposits totaling $1,898,000 and $1,186,000, respectively. In accordance with the Manual, these are nonadmitted assets.

(n) General Policyholder Dividends

The board of directors, at its discretion, determines the amount of policyholder dividends to be declared based on Pinnacol's overall experience. In May 2005, Pinnacol paid $55,067,000 in general policyholder dividends to its policyholders in good standing. This is included in dividends to policyholders on the Statutory Statements of Income and Changes in Policyholders' Surplus. No general policyholder dividends were declared or paid in 2004.

(o) Association Dividend Program

Pinnacol has an association dividend program whereby policyholders who are members of the program are entitled to a dividend based on established criteria. In 2005 and 2004, Pinnacol incurred $7,223,200 and $8,573,000, respectively, of expense related to the association dividend program. These dividends are not declared from surplus or recorded as a direct reduction to surplus. The dividends are considered premium credits and are recorded as dividends to policyholders on the Statutory Statements of Income and Changes in Policyholders' Surplus.

(p) Revenue Recognition

Premium revenue is recognized pro rata over the period the policy is effective.

(q) Reserve for Unpaid Losses and Loss Adjustment Expenses

The reserve for unpaid losses and loss adjustment expenses represents management's best estimate of ultimate net cost of all reported and unreported losses incurred through December 31. The reserves for unpaid losses and loss adjustment expenses are estimated by management using an independent third-party actuary based on individual case basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for unpaid losses and loss adjustment expenses are adequate. The estimates are continually reviewed and adjusted, as necessary, as experience develops or new information becomes known; such adjustments are included in current operations.

Pinnacol discounts certain unpaid losses on a tabular basis using a discount rate of 3.5% in 2005 and 2004. The discount rate used to calculate present value is based on an industry standard rate, which is approved by the Division. State law allows Pinnacol the use of a discount factor of up to 6.00%. As approved by the Division and in accordance with the Division's interpretation of the surplus recovery plan filed with the Division in a prior year, Pinnacol discounted its actuarially determined unpaid balances on a non-tabular basis by a factor of 3.75% as of and for the year ended December 31, 2003. As of December 31, 2003, Pinnacol achieved its goal of attaining an acceptable level of surplus as outlined in the surplus recovery plan. Therefore, Pinnacol was no longer permitted to discount actuarially determined balances on a non-tabular basis as of and for the year ended December 31, 2004, and the non-tabular discount was eliminated as of March 31, 2004.

(r) Unearned Premiums

Unearned premiums represent amounts either collected or billed and due from policyholders at December 31 but unearned at that date as they pertain to subsequent policy periods. Unearned premiums are computed on a pro rata basis over the twelve-month term of the policies.

(s) Subrogation

Subrogation claims (claims against third parties) are recognized as a reduction of losses incurred when collections are received.

(t) Reinsurance

Ceded reinsurance transactions are accounted for based on estimates of their ultimate cost. Losses, loss adjustment expenses, and the reserves for loss adjustment expenses are reported net of reinsured amounts in accordance with the Manual. Reinsurance premiums are reflected as a reduction of premiums earned (see note 6).

(u) Taxes

As a political subdivision of the State, Pinnacol is not subject to federal or state income taxes under a specific exemption granted under Section 501(c) of the Internal Revenue Code. Additionally, Pinnacol is not subject to a premium tax, pursuant to Section 8-45-117(3), C.R.S. Pinnacol is, however, subject to a surcharge on premiums received, based on a rate established annually (approximately 3.8% in 2005 and 2004), pursuant to Section 8-44-112(1)(a), C.R.S. Such amounts are included in other underwriting expenses incurred.

(v) Employee Benefits

Defined Benefit Pension Plan

Pinnacol contributes to the Combined State and School Division Trust Fund (CSSDTF), a cost-sharing multiple employer defined benefit pension plan administered by the Public Employees' Retirement Association of Colorado (PERA). CSSDTF provides retirement and disability, annual increases, and death benefits for members or their beneficiaries. All employees of Pinnacol are members of the CSSDTF. Title 24, Article 51 of the C.R.S., as amended, assigns the authority to establish benefit provisions to the state legislature. PERA issues a publicly available annual financial report that includes financial statements and required supplementary information for CSSDTF. That report may be obtained by writing to PERA of Colorado, 1300 Logan Street, Denver, Colorado 80203 or by calling PERA at 303-832-9550 or 1-800-759-PERA (7372).

Plan members and Pinnacol are required to contribute at a rate set by statute. The contribution requirements of plan members and Pinnacol are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The contribution rate for members is 8.0% and for Pinnacol is 10.15% of covered salary. Beginning with payroll periods ending on or after January 1, 2001 and before June 1, 2004, the employer contributions paid to the CSSDTF were reduced by an employer match on members' voluntary contributions to a defined contribution plan. The match, set by the board of trustees of PERA, is 100% of a member's eligible tax-deferred retirement program contributions limited by a per payroll whole percentage of PERA-includable salary limit (percentage set for

January through May 31, 2004 was 1.0%). Any unused deferred contribution match money is forwarded to the CSSDTF. With the passage and signing of Senate Bill 04-132, the employer match was suspended on June 1, 2004. Also, a portion of Pinnacol's contribution (1.10% of covered salary January 1, 2004 through June 30, 2004; 1.02% of covered salary July 1, 2004 through December 31, 2005) is allocated for the Health Care Trust Fund. Pinnacol's contributions to CSSDTF for the years ended December 31, 2005, 2004, and 2003 were $3,245,000, $2,802,000, and $2,435,000, respectively, equal to their required contributions for each year.

Pinnacol contributes to the Health Care Trust Fund (HCTF), a cost-sharing multiple employer postemployment healthcare plan administered by PERA. The HCTF provides a healthcare premium subsidy to PERA participating benefit recipients and their eligible beneficiaries. Title 24, Article 51, Part 12 of the C.R.S., as amended, assigns the authority to establish the HCTF benefit provisions to the state legislature. PERA issues a publicly available annual financial report that includes financial statements and required supplementary information for the HCTF. That report may be obtained by writing to Colorado PERA, 1300 Logan Street, Denver, Colorado 80203 or by calling PERA at 303-832-9550 or 1-800-759-PERA (7372).

Postemployment Healthcare Benefits

Pinnacol is required to contribute to HCTF at a rate of 1.02% of covered salary effective July 1, 2004 (prior to July 1, 2004, Pinnacol's contribution rate for the Health Care Trust Fund was 1.1%). No member contributions are required. The contribution requirements for Pinnacol are established under Title 24, Article 51, Part 4 of the C.R.S., as amended. The apportionment of the contribution to the HCTF is established under Title 24, Article 51, Section 208 of the C.R.S., as amended. Pinnacol's contributions to HCTF for the years ended December 31, 2005, 2004, and 2003 were $324,000, $303,000, and $318,000, respectively, equal to their required contributions for each year.

Defined Contribution Pension Plans

The CSSDTF members of Pinnacol may voluntarily contribute to the Voluntary Investment Program (401(k) Plan), an Internal Revenue Code Section 401(k) defined contribution plan administered by PERA. Plan participation is voluntary and contributions are separate from others made to PERA. Title 24, Article 51, Part 14 of the CRS, as amended, assigns the authority to establish the 401(k) Plan provisions to the state legislature. The state also offers a 457 deferred compensation plan; however, Pinnacol does not participate in it.

The 401(k) Plan is funded by voluntary member contributions up to a maximum limit set by the IRS of $14,000 in 2005 and $13,000 in 2004. Beginning January 1, 2001, an employer match was legislated which would match 100% of a member's eligible tax-deferred retirement program contributions limited by 1.0% in 2004 (through May 31, 2004) per payroll of the PERA-includable salary. With the passage and signing of Senate Bill 04-132, the employer match was suspended on June 1, 2004. The contribution requirements for Pinnacol are established under Title 24, Article 51, Section 1402 of the C.R.S., as amended. The 401(k) Plan member contributions from Pinnacol for the year ended December 31, 2005 were $1,857,000. There were no employer contributions to the 401(k) Plan from Pinnacol for the year ended December 31, 2005.

(Continued)

Pinnacol also has an alternative defined contribution plan for eligible employees. Employee contributions are based on a percentage of employees' qualified compensation. There were no employer contributions in 2005 and 2004. Employee contributions for 2005 and 2004 were $158,823 and $73,050, respectively.

Accrued Paid Leave

Pinnacol employees may accrue paid time off based on their length of service subject to certain limitations on the amount which will be paid upon termination or taken in future periods. Paid time off is recorded as an expense and a liability at the time the paid time off is earned. The estimated liability for cumulative accrued paid time off of $1,321,000 and $1,340,000 at December 31, 2005 and 2004, respectively, is included in other liabilities in the accompanying financial statements.

(2) Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses (both allocated and unallocated) represent management's best estimate of the ultimate medical and indemnity net cost of all losses and loss adjustment expenses which are incurred but unpaid at year-end. Such estimates are based on individual case estimates for reported claims and actuarial estimates for losses that have been incurred but not reported. Any change in probable ultimate liabilities is reflected in current operating results.

The estimated ultimate cost of losses is based on historical patterns and the expected impact of current socioeconomic trends. The ultimate settlement of claims will not be known in many cases for years after the time a policy expires. Court decisions and federal and state legislation between the time a policy is written and the time associated claims are ultimately settled, among other factors, may dramatically impact the ultimate cost. Due to these factors, among others, the process to estimate loss and loss adjustment reserves at a point in time cannot provide an exact forecast of future payments. Rather, it produces a best estimate of liability as of a certain date. Management believes the reserves currently estimated to be adequate. While the ultimate liability may differ from the current estimate, management does not believe the difference will have a material effect, either adverse or favorable, on Pinnacol's financial position and results of operations.

Discounting of Liabilities for Unpaid Losses or Unpaid Loss Adjustment Expenses

Pinnacol discounts its liabilities for unpaid losses for certain long-term scheduled payments.

Tabular Discount

Workers' compensation unpaid losses have been discounted on a tabular basis using a discount rate of 3.5% in 2005 and 2004. A tabular discount is calculated with reference to actuarial tables. These tables incorporate an interest rate and, in addition, factor in contingencies such as mortality, remarriage, and inflation rates. The amount of the tabular discount for unpaid losses as of December 31, 2005 and 2004, respectively, is $129,375,000 and $126,554,000. The amount of discount for case reserves at December 31, 2005, is distributed as follows over the years in which the losses were incurred:

	Loss year										
	2005	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**	**Prior**
	(In thousands)										
Amount of Discount											
Case	$ 11,365	14,110	12,822	16,442	8,535	4,417	5,265	4,055	5,687	3,196	43,481

Non-tabular Discount

As the surplus recovery plan was achieved based on the surplus level as of December 31, 2003, Pinnacol is no longer permitted to record a non-tabular discount. Therefore, an adjustment of $85,700,000 was recorded in 2004 to eliminate the non-tabular discount as a result of achieving the Plan, which increased the total reserve for unpaid losses and loss adjustment expenses and losses and loss adjustment expenses incurred. The unallocated loss adjustment expense (ULAE) was also increased in 2004 by $5,428,000 to eliminate the non-tabular discount.

Unpaid Losses and Loss Adjustment Expense

At December 31, 2005, Pinnacol accrued $1,167,693,000 for unpaid losses and allocated loss adjustment expenses. A tabular discount of $129,375,000 (computed at 3.5%) was applied in the actuarial calculation of this liability for unpaid losses and allocated loss adjustment expenses. Reserve credit of approximately $8,071,000 was recorded for high deductibles on unpaid claims at December 31, 2005.

At December 31, 2004, Pinnacol accrued $1,121,874,000 for unpaid losses and allocated loss adjustment expenses. A tabular discount of $126,554,000 (computed at 3.5%) was applied in the actuarial calculation of this liability for unpaid losses and allocated loss adjustment expenses. Reserve credit of approximately $5,900,000 was recorded for high deductibles on unpaid claims at December 31, 2004.

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

	2005		2004	
	Unpaid losses and allocated loss adjustment expenses	Unallocated loss adjustment expenses	Unpaid losses and allocated loss adjustment expenses	Unallocated loss adjustment expenses
	(In thousands)			
Balance at January 1	$ 1,121,874	37,000	997,505	26,924
Additional amounts incurred related to:				
Current year	406,819	24,236	395,302	21,361
Prior years	(42,545)	(215)	46,911	7,790
Total incurred	364,274	24,021	442,213	29,151
Reductions relating to payments for:				
Current year	99,266	14,224	101,428	11,659
Prior years	219,189	8,797	216,416	7,416
Total paid	318,455	23,021	317,844	19,075
Balance at December 31	$ 1,167,693	38,000	1,121,874	37,000

As a result of changes in estimates of insured events in prior years, the provision for unpaid losses and allocated loss adjustment expenses decreased by $42,545,000 in 2005. The changes are generally the result of ongoing analysis of recent loss development trends and better development efforts. The provision for unpaid losses and allocated loss adjustment expenses increased by $46,911,000 in 2004. The increase is primarily due to the adjustment recorded to eliminate the non-tabular discount. Original estimates are increased or decreased, as additional information becomes known regarding individual claims.

(3) Investments

Estimated fair value of investments in bonds is based on values published by the Securities Valuation Office (SVO) of the NAIC. However for certain investments, the SVO does not provide a fair market value. For those investments, the quoted market value prices as provided by accepted external pricing vendors may be used as a substitute for the SVO market price. In 2005, Interactive Data Corporation (IDC) was used to obtain fair market values and Hub Data was used in 2004.

The SVO of the NAIC designates ratings of bonds from 1 to 6. Bonds with ratings of 1-2 are stated at amortized cost using the interest method. Bonds with ratings of 3-6 require the bond to be carried at the lower of amortized cost or market with any related unrealized loss reported in surplus. During 2005, Pinnacol had an investment in a bond where the SVO designated the bond at a 3 rating. This resulted in an unrealized loss of $2,308,000 that is reported in surplus.

The amortized cost and the fair value of investments in bonds are summarized as follows:

	2005			
	Amortized cost	**Unrealized gains**	**Unrealized losses**	**Fair value**
	(In thousands)			
U.S. government obligations:				
Nonloan-backed bonds	$ 373,032	8,911	(3,175)	378,768
Loan-backed bonds	450,669	2,432	(8,901)	444,200
Special revenue:				
Loan-backed bonds	59,930	70	(908)	59,092
Industrial and miscellaneous:				
Nonloan-backed bonds	633,091	23,487	(9,188)	647,390
Loan-backed bonds	19,986	146	—	20,132
	$ 1,536,708	35,046	(22,172)	1,549,582

	2004			
	Amortized cost	**Unrealized gains**	**Unrealized losses**	**Fair value**
	(In thousands)			
U.S. government obligations:				
Nonloan-backed bonds	$ 145,816	12,686	(149)	158,353
Loan-backed bonds	20,157	322	—	20,479
Special revenue:				
Loan-backed bonds	365,301	5,394	(1,693)	369,002
Industrial and miscellaneous:				
Nonloan-backed bonds	587,217	38,580	(2,218)	623,579
Loan-backed bonds	174,237	2,614	(1,939)	174,912
	$ 1,292,728	59,596	(5,999)	1,346,325

The amortized cost and fair value of investments in debt securities at December 31, 2005, by contractual maturity, are shown below. Contractual maturities may differ from actual maturities because the borrower may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized cost	**Fair value**
	(In thousands)	
Due in one year or less	$ 26,500	26,576
Due after one year through five years	377,367	381,285
Due after five years through ten years	495,864	497,071
Due after ten years	636,977	644,650
	$ 1,536,708	1,549,582

Proceeds from sales of investments in bonds during 2005 and 2004 were $164,359,000 and $290,846,000, respectively. Gross gains of $3,531,000 and $8,402,000 and gross losses of $(22,000) and $(178,000) were realized on those sales for 2005 and 2004, respectively.

Unrealized gains and losses on investments in common stocks are reported directly in surplus. The gross unrealized gains and losses on and cost and fair value of those investments are summarized as follows:

		Cost	Gross unrealized gains	Gross unrealized losses	Fair value
			(In thousands)		
December 31, 2005:					
Common stocks	$	140,634	19,117	—	159,751
December 31, 2004:					
Common stocks	$	127,372	13,332	(5)	140,699

The following table provides the length of impairment for those investments in bonds with an unrealized loss as of December 31, 2005:

		Less than 12 months		12 months or greater		Total	
Description of securities		Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
				(In thousands)			
Government obligations	$	269,923	(3,011)	12,818	(164)	282,741	(3,175)
Special revenue and special assessment obligations		57,824	(908)	—	—	57,824	(908)
Industrial and miscellaneous		198,293	(5,809)	69,264	(3,379)	267,557	(9,188)
Mortgage-backed securities		156,392	(3,122)	119,371	(5,779)	275,763	(8,901)
Total	$	682,432	(12,850)	201,453	(9,322)	883,885	(22,172)

There are 84 securities in an unrealized loss position as of December 31, 2005.

(a) Government Obligations

Any unrealized losses in government securities are due to interest rate fluctuations. Because of the ability to hold to maturity, plus the credit quality of government securities, government obligation unrealized losses are considered temporary.

(b) Special Revenue Obligations

Special revenue obligations are almost always insured, can be held to maturity, and any unrealized losses are typically considered temporary.

(c) Industrial and Miscellaneous Bonds

Investment grade bonds held in the portfolio all have a BBB- rating or higher. All bonds can be held to maturity and any unrealized losses are considered temporary.

(d) Mortgage-Backed Securities

These are securities backed by federal agency status. Any unrealized losses in government securities are due to interest rate fluctuations. Because of the ability to hold to maturity, plus the credit quality of the securities, mortgage-backed securities unrealized losses are considered temporary.

Major categories of net investment income for the years ended December 31, 2005 and 2004 are summarized as follows:

		2005	**2004**
		(In thousands)	
Investment income:			
Corporate and miscellaneous bonds	$	63,719	62,636
U.S. government obligations		14,541	10,192
Cash and other investments		2,207	3,513
Real estate		3,619	3,487
Equity securities		3,993	2,770
Securities lending		—	469
Repurchase/reverse repurchase		742	42
Investment expenses		(3,221)	(2,637)
Net investment income		85,600	80,472
Net realized gains		3,508	23,331
Investment income	$	89,108	103,803

(4) Repurchase and Reverse Repurchase Transactions

Pinnacol enters into repurchase and reverse repurchase agreements where the Company agrees to sell securities and simultaneously agrees to repurchase the same or substantially the same securities in the future (reverse repurchase agreement) while also entering into an agreement to purchase securities and simultaneously agrees to resell the same or substantially the same securities in the future (repurchase agreement). The broker-dealer provides securities as collateral equal to or exceeding 105% of the market value of securities transferred into the program. Pinnacol had outstanding U.S. government securities with fair values of approximately $884,739,000 and $679,279,000 and a cost of approximately $871,204,000, and $667,491,000 as of December 31, 2005 and December 31, 2004, respectively.

Pinnacol has no additional credit risk exposure to borrowers. The contract with the broker-dealer requires the broker-dealer to indemnify Pinnacol if the broker-dealer fails to return the securities or fails to pay Pinnacol for income distributions by the securities' issuers while the securities remain in the program. Either Pinnacol or the broker-dealer can terminate all repurchase and reverse repurchase transactions on demand.

(5) Transactions With the State

The state contracts with Pinnacol pursuant to its self-funded insurance program. The state reimburses Pinnacol for all workers' compensation claims and loss adjustment expenses as incurred. Pinnacol accounts for the state contract as an uninsured and partially insured accident and health plan whereby Pinnacol does not record the premium revenue or loss and loss adjustment expenses and related receivables and payables for state workers' compensation costs. Reimbursements billed to the state under this contract were $27,506,000 and $27,897,000 in 2005 and 2004, respectively.

(6) Reinsurance

Pinnacol purchases catastrophic reinsurance for risks in excess of its retention limits on workers' compensation insurance policies written. Coverage for policies is provided under the following terms:

Period	Reinsurance coverage
Prior to January 1, 2002	Individual workers' compensation accidents of up to $20,000,000 in excess of retention of $6,000,000 per occurrence
January 1, 2002 to April 30, 2002	No catastrophic reinsurance was in place
May 1, 2002 to May 1, 2004	Individual workers' compensation accidents of up to $20,000,000 in excess of retention of $20,000,000 per occurrence
March 1, 2004 to April 30, 2005	Individual workers' compensation accidents of up to $15,000,000 in excess of retention of $5,000,000 per occurrence Individual workers' compensation accidents of up to $40,000,000 in excess of retention of $40,000,000 per occurrence
May 1, 2005 to present	Individual workers' compensation accidents of up to $15,000,000 in excess of retention of $5,000,000 per occurrence; Pinnacol retains 40% within this range of loss Individual workers' compensation accidents of up to $20,000,000 in excess of retention of $20,000,000 per occurrence Individual workers' compensation accidents of up to $40,000,000 in excess of retention of $40,000,000 per occurrence

Management is not aware of any catastrophes during any of the aforementioned policy periods.

Effective March 1, 2004, Pinnacol executed a reinsurance contract with Argonaut Insurance Company (a California corporation) for Other States Coverage that is in effect as of December 31, 2005. The contract is designed as a 100% quota share arrangement with Pinnacol acting as the assuming company. This allows Pinnacol to provide insurance coverage under the workers' compensation provisions of other states for the employees of Colorado employer companies who work outside of Colorado. Premium revenue is recognized pro rata over the period the policy is effective.

The following reinsurance activity has been recorded in the accompanying statutory financial statements:

		2005	2004
		(In thousands)	
Gross premiums earned	$	563,454	516,074
Premiums ceded		(2,642)	(2,753)
Premiums assumed		5,658	2,150
Net premiums earned	$	566,470	515,471
Gross losses incurred	$	383,997	468,345
Losses assumed		4,298	3,019
Net losses incurred	$	388,295	471,364

Should the reinsurers be unable to meet their obligations under the reinsurance contracts, Pinnacol would remain liable for amounts ceded to its reinsurers. Reinsurance contracts do not relieve Pinnacol of its obligations, and a failure of the reinsurer to honor its obligations could result in losses to Pinnacol. Pinnacol evaluates and monitors the financial condition of its reinsurers to minimize its exposure to loss from reinsurer insolvency. Management of Pinnacol believes its reinsurers are financially sound and will continue to meet their contractual obligations.

Pinnacol's reinsurers had the following AM Best ratings at December 31, 2005:

Reinsurer	AM Best rating
AXIS Specialty Corporation	A
Endurance Specialty Insurance Limited	A
Platinum Underwriters Reinsurance	Ag
Renaissance Reinsurance Ltd.	A+u
Aspen Insurance UK Ltd.	A
Danish RE Underwrting Agencies Lloyds	NR
Danish RE Underwrting Agencies Britian	A
Lloyds Underwriter Syndicate No 2987B	A
Lloyds Underwriter Syndicate No 2780AD	NR

(7) Policyholders' Surplus

Pinnacol had policyholders' surplus of $471,849,000 and $365,794,000 as of December 31, 2005 and 2004, respectively. Prior to and as of December 31, 2002, surplus was below regulatory levels considered acceptable in the industry. In response to Section 8-45-111, C.R.S., management of Pinnacol had developed, filed, and received approval, effective January 1, 2001, of a Surplus Recovery Plan (the Plan) to strengthen its financial position and attain "a reasonable policyholders' surplus." The Plan called for Pinnacol to achieve the "company action level of risk-based capital." Risk-based capital is a regulatory measure of capital adequacy and the "company action level" is the minimum level of risk-based capital required by insurance regulation (i.e., the level at which the Division requires a plan for corrective action).

(Continued)

Risk-based capital includes factors that relate to the size of the entity, the perceived risks in the company's business, and also factors relating to the insurance industry in general.

The Plan was achieved and Pinnacol has attained an acceptable level of surplus as outlined in the state statutes based on the surplus level as of December 31, 2003. This surplus level was verified through a triennial examination conducted by the Division that was completed on November 8, 2004. Accordingly, the nontabular reserve discount was eliminated during 2004.

The risk-based capital calculation allows a company to compute surplus using discounted tabular reserves, which are indemnity reserves that are calculated using discounts determined with reference to actuarial tables. Nontabular discounted reserves must be adjusted back to get to adjusted capital as defined for risk-based capital purposes. Pinnacol has achieved the "company action level of risk-based capital" as outlined in the Plan, and Pinnacol's surplus is computed using undiscounted reserves as of December 31, 2004. An adjustment of $91,085,000 was recorded in 2004 to eliminate the nontabular discount as a result of achieving the Plan, which increased the total reserve for unpaid losses and loss adjustment expenses and losses and loss adjustment expenses incurred.

As a result of attaining an acceptable level of surplus in 2004, Pinnacol paid $55,067,000 in general policyholder dividends to its policyholders in good standing. An acceptable level of surplus is that which exceeds the Company action level of risk-based capital, which is $141,404,000 for 2005. This is included in Dividends to Policyholders on the Statutory Statements of Income and Changes in Policyholders' Surplus and reduces net income for the year ending December 31, 2005.

(8) Uncollected Premiums

At December 31, 2005 and 2004, Pinnacol had admitted assets of $57,985,000 and $45,578,000, respectively, representing premiums receivable. Pinnacol routinely assesses the collectibility of these receivables. Based upon Pinnacol's experience approximately 1% of the earned premium may become uncollectible.

(9) Commitments and Contingencies

Pinnacol is a party to various claims and lawsuits that arise in the normal course of its business. Management of Pinnacol believes that liabilities that may arise due to the resolution of these matters, if any, will not have a material adverse effect on policyholders' surplus, the results of operations, and/or liquidity of Pinnacol.

At December 31, 2005 and 2004, Pinnacol had letters of credit for assumptive reinsurance agreements. Pinnacol had a letter of credit for the benefit of Fireman's Fund Insurance Company for approximately $5,454,000 and $6,403,000 at December 31, 2005 and 2004, respectively. Pinnacol had a letter of credit for the benefit of Argonaut Insurance Company for $9,103,000 and $4,813,000 at December 31, 2005 and 2004, respectively. Pinnacol had a letter of credit for the benefit of Reliance Insurance Company for approximately $902,000 at December 31, 2005 and 2004, respectively. These reinsurance agreements allow the companies to draw upon the respective letters of credit, which are collateralized at 112%, at any time to secure any of Pinnacol's obligations under the agreements. Included in cash, cash equivalents, short-term investments and other invested assets are amounts held as collateral for letters of credit for reinsurance agreements of $18,396,000 and $15,117,000 as of December 31, 2005 and 2004, respectively.

Pinnacol is contingently liable for approximately $63,813,000 of claims closed by the purchase of annuities from life insurers for structured settlements. No provision has been made for this contingency as management believes that any payments related to this contingency are remote.

At December 31, 2005, the aggregate amount of annuities due from all life insurers equaled the amount of the reserves eliminated when the annuities were purchased and consisted of the following:

Life insurance company and location		**Loss reserves eliminated by annuities**
		(In thousands)
Genworth Financial, Virginia	$	39,550
Symetra Financial, Washington		19,897
Metlife, New York		2,600
Allstate, Illinois		1,547
Liberty Life Assurance Company, Massachusetts		219
	$	63,813

(10) Subsequent Events

As Pinnacol has attained an acceptable level of surplus, the board of directors held a meeting on April 5, 2006 in which it declared and is planning to pay a general dividend of approximately $57,000,000 in 2006 to its policyholders with policies in good standing. The board of directors, at its discretion, determines the amount of policyholder dividends to be declared based on Pinnacol's overall experience and financial condition.

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Investment Risks Interrogatories

December 31, 2005

Pinnacol's total admitted assets as reported on page two of its Annual Statement are $1,828,349,008.

1. The following are the 10 largest exposures to a single issuer/borrower/investment by investment category, excluding: (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt, (ii) property occupied by Pinnacol, and (iii) policy loans:

Investment category/issuer	Amount	Percentage of total admitted assets
Bonds:		
a. General Electric	$ 37,766,728	2.07%
b. Proctor and Gamble	29,927,792	1.64
c. Verizon	29,742,994	1.63
d. IBM Corporation	25,976,275	1.42
e. Anheuser Busch	24,934,110	1.36
f. CITI Group	24,911,916	1.36
g. Ford Motor Credit	21,954,000	1.20
h. Johnson and Johnson	21,139,844	1.16
i. Emerson Electric	20,565,630	1.12
j. Legget and Platt	19,994,192	1.09

2. Pinnacol's total admitted assets held in bonds and preferred stocks, by NAIC rating, are:

Bonds			Preferred stocks		
NAIC rating	Amount	Percentage of total admitted assets	NAIC rating	Amount	Percentage of total admitted assets
NAIC-1	$ 1,484,796,900	81.21%	P/PSF-1	$	
NAIC-2	24,903,384	1.36	P/PSF-2		
NAIC-3	27,007,275	1.48	P/PSF-3		
NAIC-4			P/PSF-4		
NAIC-5			P/PSF-5		
NAIC-6			P/PSF-6		
	$ 1,536,707,559			$ —	

3. Assets held in foreign investments are less than 2.5% of Pinnacol's total admitted assets.

4. Assets held in Canadian investments are less than 2.5% of Pinnacol's total assets. (none)

5. Assets held in investments with contractual sales restrictions are less than 2.5% of Pinnacol's total admitted assets. (none)

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Investment Risks Interrogatories

December 31, 2005

6. The following are the largest equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other securities and excluding money market and bond mutual funds listed in the Appendix to the *SVO Purposes and Procedures Manual* as exempt or Class 1):

Investment category/issuer		Amount	Percentage of total admitted assets
a. Vanguard Total Stock Market Index Inst	$	33,858,673	1.85%
b. Vanguard Total Stock Market Index ADM		32,195,420	1.76
c. Vanguard Total Stock Market Index INV		32,155,683	1.76
d. Vanguard Total Stock Market Vipers		31,719,153	1.73
e. T Rowe Price Small Cap		19,721,433	1.08
f. Julius Baer International Equity		10,100,880	0.55

7. Assets held in nonaffiliated, privately placed equities are less than 2.5% of Pinnacol's total admitted assets. (none)

8. Assets held in general partnership interests are less than 2.5% of Pinnacol's total admitted assets. (none)

9. Mortgage loans reported in schedule B are less than 2.5% of Pinnacol's total admitted assets. (none)

10. Assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in schedule A less than 2.5% of Pinnacol's total admitted assets. (none)

11. Pinnacol's total admitted assets are subject to the following types of agreements as of the following dates:

		Year-end				End of each quarter	
					1st Quarter	2nd Quarter	3rd Quarter
						(Unaudited)	
		Amount	Percentage of total admitted assets		Amount	Amount	Amount
a. Securities lending (do not include assets held as collateral for such transactions)	$	—	—%	$	—	—	—
b. Repurchase agreements		—	—		—	—	—
c. Reverse repurchase agreements		884,739,495	48.3		782,538,000	819,570,000	890,587,120
d. Dollar repurchase agreements		—	—		—	—	—
e. Dollar reverse repurchase agreements		—	—		—	—	—

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Investment Risks Interrogatories

December 31, 2005

12. Warrants not attached to other financial instruments, options, caps, and floors are:

	Owned		Written	
	Amount	**Percentage of total admitted assets**	**Amount**	**Percentage of total admitted assets**
a. Hedging	$ (none)		$ (none)	
b. Income generation	(none)		(none)	
c. Other	(none)		(none)	

13. Pinnacol's potential exposure (defined as the amount determined in accordance with the NAIC *Annual Statement Instructions*) for collars, swaps, and forwards as of the following dates:

	Year-end		End of each quarter 1st Quarter	2nd Quarter	3rd Quarter
				(Unaudited)	
	Amount	**Percentage of total admitted assets**	**Amount**	**Amount**	**Amount**
a. Hedging	$ (none)		$ (none)	(none)	(none)
b. Income generation	(none)		(none)	(none)	(none)
c. Replications	(none)		(none)	(none)	(none)
d. Other	(none)		(none)	(none)	(none)

14. Pinnacol's potential exposure (defined as the amount determined in accordance with the NAIC *Annual Statement Instructions*) for futures contracts as of the following dates:

	Year-end		End of each quarter 1st Quarter	2nd Quarter	3rd Quarter
				(Unaudited)	
	Amount	**Percentage of total admitted assets**	**Amount**	**Amount**	**Amount**
a. Hedging	$ (none)		$ (none)	(none)	(none)
b. Income generation	(none)		(none)	(none)	(none)
c. Replications	(none)		(none)	(none)	(none)
d. Other	(none)		(none)	(none)	(none)

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Investment Risks Interrogatories

December 31, 2005

15. The largest investment included in the write-ins for invested assets category included on the Summary Investment Schedule is as follows:

Investment		Amount	Percentage of total admitted assets
a. Wells Fargo Bank – U.S. Treasury note	$	13,560,000	0.74%

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Summary Investment Schedule

December 31, 2005

Investment categories	Gross investment holdings* Amount	Gross investment holdings* Percentage of gross investment holdings	Admitted assets as reported in the annual statement Amount	Admitted assets as reported in the annual statement Percentage of total admitted assets
Bonds:				
U.S. treasury securities	$ 350,534,931	19.99%	$ 350,534,931	19.99%
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	—	—	—	—
Issued by U.S. government-sponsored agencies	22,496,943	1.28	22,496,943	1.28
Foreign government (including Canada, excluding mortgage-backed securities)	—	—	—	—
Securities issued by states, territories, and possessions and their political subdivisions in the U.S.:				
State, territory, and possessions – general obligations	—	—	—	—
Political subdivisions of states, territories, and possessions – general obligations	—	—	—	—
Revenue and assessment obligations	—	—	—	—
Industrial development and similar obligations	—	—	—	—
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Guaranteed by GNMA	16,948,352	0.97	16,948,352	0.97
Issued by FNMA and FHLMC	59,930,235	3.42	59,930,235	3.42
Privately issued	10,000,000	0.57	10,000,000	0.57
CMOs and REMICs:				
Issued by FNMA and FHLMC	—	—	—	—
Privately issued and collateralized by MBS issued or guaranteed by GNMA, FMNA, or FHLMC	423,190,926	24.13	423,190,926	24.13
All other privately issued	529,787	0.03	529,787	0.03
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	640,107,551	36.50	640,107,551	36.50
Unaffiliated foreign securities	12,968,834	0.74	12,968,834	0.74
Affiliated securities	—	—	—	—
Equity interests:				
Investments in mutual funds	159,751,241	9.11	159,751,241	9.11
Preferred stocks:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Publicly traded equity securities (excluding preferred stocks):				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—

PINNACOL ASSURANCE

Supplemental Schedule of Investment
Information – Summary Investment Schedule

December 31, 2005

Investment categories	Gross investment holdings* Amount	Gross investment holdings* Percentage of gross investment holdings	Admitted assets as reported in the annual statement Amount	Admitted assets as reported in the annual statement Percentage of total admitted assets
Other equity securities:				
Affiliated	$ —	—%	$ —	—%
Unaffiliated	—	—	—	—
Other equity interests including tangible personal property under lease:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Mortgage loans:				
Construction and land development	—	—	—	—
Agricultural	—	—	—	—
Single-family residential properties	—	—	—	—
Multifamily residential properties	—	—	—	—
Commercial loans	—	—	—	—
Real estate investments:				
Property occupied by company	22,884,996	1.30	22,884,996	1.30
Property held for production of income	—	—	—	—
Property issued or guaranteed by GNMA, FMNA	—	—	—	—
Collateral loans	—	—	—	—
Policy loans	—	—	—	—
Receivables for securities	—	—	—	—
Cash and short-term investments	20,954,028	1.19	20,954,028	1.19
Write-ins for invested assets	13,560,000	0.77	13,560,000	0.77
Total invested assets	$ 1,753,857,824	100.00%	$ 1,753,857,824	100.00%

* Gross investment holdings as valued in compliance with NAIC *Accounting Practices and Procedures Manual*

See accompanying independent auditors' report.

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

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

Members of the Legislative Audit Committee and
the Pinnacol Assurance Board of Directors:

We have audited the statutory financial statements of Pinnacol Assurance (Pinnacol) as of and for the year ended December 31, 2005, and have issued our report thereon dated April 7, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Pinnacol's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pinnacol's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and the use of the members of the Legislative Audit Committee, the board of directors and management of Pinnacol, and state insurance departments to whose jurisdiction Pinnacol is subject and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

April 7, 2006

PINNACOL ASSURANCE

Statutory Financial Statements

December 31, 2005

Distribution

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