STATEWIDE SINGLE AUDIT
FISCAL YEAR ENDED JUNE 30, 2012
Report Summary

Dianne E. Ray, CPA
State Auditor

State of Colorado

AUTHORITY, PURPOSE, AND SCOPE

This audit was conducted under the authority of Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and with *Government Auditing Standards* issued by the Comptroller General of the United States. We performed our audit work during the period from February through December 2012.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the Fiscal Year Ended June 30, 2012.
- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the Fiscal Year Ended June 30, 2012.
- Review internal accounting and administrative control procedures, as required by generally accepted auditing standards and *Government Auditing Standards.*
- Evaluate compliance with applicable state and federal laws, rules, and regulations.
- Evaluate progress in implementing prior years' audit recommendations.

OVERVIEW OF FINDINGS AND AUDITOR'S OPINIONS

This report presents our financial and compliance audit of the State of Colorado for Fiscal Year 2012. The report may not include all findings and recommendations from separately issued reports on audits of state departments, institutions, and agencies. However, in accordance with the federal Single Audit Act, this report includes all findings and questioned costs related to federal awards that came to our attention through our audit.

We made 57 recommendations to state agencies and higher education institutions.

FINANCIAL STATEMENT FINDINGS

- The State's financial statements covered $30.6 billion in total assets and $24.8 billion in total expenditures.
- We have issued an **unqualified opinion** on the State's financial statements for the Fiscal Year Ended June 30, 2012. That means the State's financial statements presented fairly, in all material respects, the State's financial position, results of all financial operations, and cash flows in conformance with generally accepted accounting principles.
- We identified **20 internal control weaknesses** related to compliance with internal control over financial reporting and other matters.

FEDERAL PROGRAM FINDINGS

The State expended approximately $10.7 billion in federal funds in Fiscal Year 2012. The four largest federal programs were:

- Medicaid: $2.4 billion
- Unemployment Insurance: $1.6 billion
- Supplemental Nutrition Assistance Program: $867 million
- Temporary Assistance for Needy Families: $169 million

- We identified **37 internal control issues** related to the State's compliance with requirements applicable to major federal programs.
- We identified nearly **$285,000 in questioned costs** related to federal awards granted to the State.

For further information about this report, contact the Office of the State Auditor
303.869.2800 - www.state.co.us/auditor

FINANCIAL STATEMENT FINDINGS

This section summarizes our report on the State's compliance with internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards.* These standards and Statement on Auditing Standards No. 115 issued by the American Institute of Certified Public Accountants require that we communicate matters related to the State's internal control over financial reporting identified during our audit of the State's financial statements.

Internal Controls Over Financial Activity

State agencies are responsible for having adequate internal controls in place to ensure compliance with laws and regulations and with management's objectives. We tested controls over the processing of transactions and accounting for financial activity and identified the need for improvements in the following areas:

- **Controls Over Accounting Transactions:**
  - The Colorado Historical Society does not have strong internal controls in place to ensure the proper preparation of accounting entries, timely reconciliations, year- end reporting, and segregation of duties.
  - The Department of Labor and Employment overstated its Federal Unemployment Act interest expense by $10 million, due to a lack of adequate review and reconciliation of the balance throughout the year.
  - The Department of Human Services did not have strong internal controls over the preparation and submission of year-end reports; the accuracy of data contained in the Colorado Financial Reporting System (COFRS), the State's accounting system, and the County Financial Management System; and cash collections.

- **Controls Over Procurement Cards:** The Department of Revenue staff did not consistently follow the Department's existing procurement card guidelines, resulting in numerous transactional errors. Further, the Department did not have internal controls in place to identify coding errors made while recording the transactions on COFRS and did not require staff to follow procurement card procedures.

- **Controls Over a Management Company:** The State Board of Land Commissioners (the Board), within the Department of Natural Resources, did not assign accounting staff to review the financial reports and recorded transactions of a management company that co-manages the Board's commercial properties. Further, the Board did not obtain approval from the Department of Treasury prior to opening bank accounts that the management company utilized. In addition, the Board failed to establish and implement policies and procedures to record revenue and expenditure amounts related to its commercial properties and did not seek the guidance of the Department of Natural Resources Controller to ensure that it utilized the appropriate contract type for the management company activities.

- **Establishing Internal Controls:**
  - The Medical Marijuana Enforcement Division, within the Department of Revenue, did not establish and adopt written internal control policies and procedures related to reconciliations over cash and revenue collections, proper revenue recognition, segregation of duties over cash collection and recording, and state asset tracking.
  - The State Board of Land Commissioners, within the Department of Natural Resources, has not established and implemented procedures to estimate the value of donated land so that

information can be tracked internally and recorded as asset values in COFRS. Further, it does not record its assets obtained through exchange transactions on timely basis.

Internal Controls Over Financial Reporting

State agencies are responsible for reporting financial activity accurately, timely, and completely. The Office of the State Controller establishes standard policies and procedures that must be followed by state agencies and institutions. As part of our audit, we reviewed the agencies' and institutions' internal control processes, including policies and procedures, related to financial reporting and tested a sample of financial transactions to ensure that internal controls were adequate and that financial activity was reported properly.

One example of an internal control weakness occurred at the Department of Personnel & Administration. Specifically, the Office of the State Controller did not include higher education tuition and fee amounts shown in the Fiscal Year 2012 General Appropriations Act in the State's Budget-to-Actual Cash Funded Schedule, within the State's financial statements. This caused inconsistencies in the comparison between the Fiscal Years 2011 and 2012 budget-to-actual details, since the amounts had been included in the Fiscal Year 2011 schedule.

> Professional standards define the following three levels of internal control weaknesses that must be reported. Prior to each recommendation in this report, we have indicated the classification of the finding.
>
> A *material weakness* is the most serious level of internal control weakness. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.
>
> A *significant deficiency* is a moderate level of internal control weakness. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
>
> A *deficiency in internal control* is the least serious level of internal control weakness. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. Deficiencies in internal control generally are reported to agencies in separate management letters and, therefore, would not be included in this report.

Internal Controls Over Information Technology Systems

State agencies, in cooperation with the Governor's Office of Information Technology (OIT), are responsible for implementing, maintaining, and adequately securing the state's computer systems. During our Fiscal Year 2012 audit, we determined that some state agencies' computer systems did not comply with information technology-related auditing standards and/or the Colorado Information Security Policies. Specifically, we identified problems with a total of eight computer systems at five agencies, resulting in 11 audit recommendations to the applicable agencies and OIT. The following bullets describe notable examples of these issues:

- The Department of Health Care Policy and Financing, the Department of Human Services, and OIT did not hold the service provider for the Colorado Benefits Management System (CBMS) accountable for implementing information system controls. CBMS is the eligibility system for the following programs: Medicaid, Children's Basic Health Plan, Temporary Assistance for Needy Families, and the Supplemental Nutrition Assistance Program.

- The Department of Personnel & Administration and OIT did not implement adequate controls related to access management, network controls, disaster recovery and backups, and succession planning over the Colorado Personnel Payroll System (CPPS). CPPS is the State's integrated human resources and payroll management system.

- The Department of Labor and Employment did not fully implement our Fiscal Year 2009 recommendation to improve information system controls over the Colorado Unemployment Benefits System and the Colorado Automated Tax System. These systems are used to process unemployment benefits and collect unemployment taxes.

Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2012, which is available electronically from the Office of the State Controller's website at http://www.colorado.gov/dpa/dfp/sco/CAFR/cafr12/cafr12.pdf.

FEDERAL PROGRAM FINDINGS

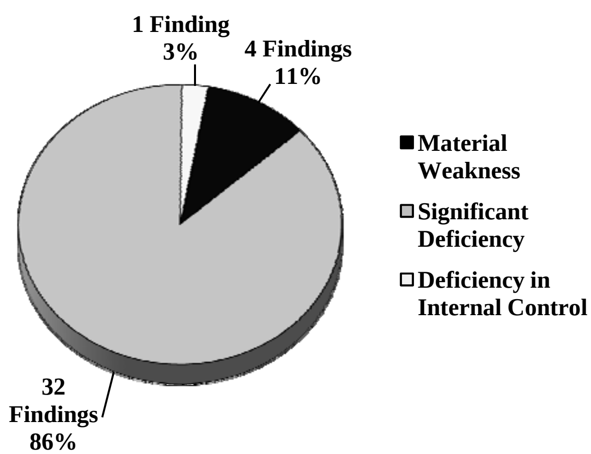
This section summarizes our report on the State's compliance with requirements applicable to major federal programs and internal control over compliance in accordance with the federal Office of Management and Budget's (OMB) *Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. We planned and performed the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements that could have a direct and material effect on a major federal program occurred. As part of our audit, we determined the State's compliance with federal regulations and grant requirements, such as activities allowed or unallowed, allowable costs, cash management, eligibility, reporting, and subrecipient monitoring. Our testing of the State's expenditures of federal grant award funds included nearly $900 million expended under the federal American Recovery and Reinvestment Act of 2009 (Recovery Act).

As with matters identified during our audit of the State's internal control over financial reporting, we are required to communicate three levels of internal control issues related to each of the major federal programs.

Internal Controls Over Federal Programs

The following table shows the breakout of types of internal control weaknesses over compliance with federal requirements that we identified during Fiscal Year 2012. Prior to each recommendation in this report, we have indicated the classification of the finding.

Federal Compliance
Internal Control Weaknesses
Fiscal Year 2012



A *material weakness* is the most serious level of internal control weakness. A material weakness is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

A *significant deficiency* is a moderate level of internal control weakness. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over compliance with a compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

A deficiency in internal control is the least serious level of internal control weakness. A deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a compliance requirement of a federal program on a timely basis.

Compliance With Federal Program Requirements and Federal Reporting

Various state departments administer federal programs in Colorado and are required to comply with federal program requirements. We identified problems with several departments' compliance with those requirements. In the following bullets, we first discuss federal compliance issues at two departments—the Department of Human Services and the Department of Health Care Policy and Financing—that administer the State's largest federal programs that provide health care and human services benefits. We also describe federal compliance problems at three other state agencies that administer federal programs.

- **Department of Human Services:** The Department was not in compliance with federal requirements for three out of nine programs we tested at the Department during our Fiscal Year 2012 audit. The following bullets provide examples of federal compliance issues we identified with specific Department programs.

    - **Vocational Rehabilitation Program:** The Department has not ensured that field counselors understand and comply with requirements regarding eligibility determinations, such as the maintenance of supporting documentation; timeliness of eligibility determinations; and accuracy of data entry. We identified this as a material weakness for the program.
    - **Temporary Assistance for Needy Families Program:** The Department did not provide adequate guidance and training to counties regarding case file documentation; requirements to follow up on Income, Eligibility, and Verification System information; data entry; and timely application processing. We identified this as a material weakness for the program.
    - **Supplemental Nutrition Assistance Program**: The Department did not provide training to counties regarding requirements for accurate data entry and timely beneficiary changes related to restoration payments. We identified this as a significant deficiency.

- **Department of Health Care Policy and Financing:** Overall, the Department improved its internal controls over the Medicaid and Children's Basic Health Plan programs. While our Fiscal Year 2011 audit identified five material weaknesses, our Fiscal Year 2012 audit did not identify material weaknesses, however, we identified significant deficiencies and deficiencies in internal control. The following bullets provide examples of federal compliance issues we identified with specific Department programs.

    - **Medicaid:** We found problems with the Department's management of the Medicaid program. For example, the Department lacked adequate internal controls over the determination of Medicaid provider eligibility, determination of individuals' Medicaid eligibility, and processing of Medicaid applications. We identified this as a significant deficiency.
    - **Children's Basic Health Plan (CBHP):** The Department lacked adequate internal controls over eligibility determination for CBHP recipients and processing of CBHP applications. We identified this as a significant deficiency.
    - **Colorado Benefits Management System (CBMS):** The Department uses CBMS to determine individuals' eligibility for Medicaid and CBHP benefits. We found that the Department did not adequately monitor county departments of human/social services to identify data entry errors in CBMS related to Medicaid eligibility. We identified this as a significant deficiency.

- **Department of Public Health and Environment:** The Department was not in compliance with federal requirements for three out of five programs we tested at the Department during our Fiscal Year 2012 audit. The following bullets provide examples of federal compliance issues we identified with specific Department programs.

- **Superfund Program:** The Department did not provide evidence to show that it verified that contractors were not suspended, debarred, or otherwise excluded for 50 percent of contracts sampled. In addition, the contracts within the sample did not include required suspension and debarment language. We identified this as a significant deficiency.
- **Centers for Disease Control and Prevention Investigations and Technical Assistance Program:** The Department does not have procedures in place to ensure that staff conduct supervisory reviews of progress reports the Department submits to its federal oversight agency. We identified this as a significant deficiency.
- **Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Program:** The Department does not have procedures in place requiring that evidence of a supervisory review be maintained over all Federal Funding Accountability and Transparency Act reports submitted for the WIC program. Rather, it only requires that staff perform a supervisory review of a sample of reports submitted each month. We identified this as a significant deficiency.

- **Department of Labor and Employment:** The Department was not in compliance with federal requirements for one out of two programs we tested at the Department during our Fiscal Year 2012 audit. The following bullet provides an example of the federal compliance issue we identified at one Department program.

  - **Unemployment Insurance Program:** The Department did not cross-check unemployment insurance payments against the National Directory of New Hires to verify that recipients of Unemployment Insurance benefit payments were not simultaneously employed. We identified this as a significant deficiency.

- **Governor's Energy Office:** The Governor's Energy Office was not in compliance with federal requirements for two out of three programs we tested at the Governor's Office during our Fiscal Year 2012 audit. The following bullets provide examples of federal compliance issues we identified at specific Governor's Energy Office programs.

  - **State Energy Program:** The Governor's Energy Office continues to improperly charge employee personnel costs to this program as a result of not having a policy in place that requires staff to review and approve all transactions, including journal entries, prior to charging them to the grant. In addition, the Governor's Energy Office did not comply with federal requirements related to subrecipient monitoring. Specifically, the Governor's Energy Office did not obtain and review OMB *Circular A-133* reports for subrecipients that expended more than $500,000 in federal awards. We identified these issues as significant deficiencies.
  - **Weatherization Assistance Program:** The Governor's Energy Office does not have procedures in place to ensure that staff maintain evidence of a supervisory review of its Recovery Act Section 1512 and Federal Financial Reporting reports. We identified this as a significant deficiency.

Summary of Progress in Implementing Prior Recommendations

This report includes an assessment of our disposition of audit recommendations reported in the previous Statewide Single Audit Reports. Prior years' recommendations that were implemented in Fiscal Year 2011 or earlier are not included.

Outstanding Statewide Single Audit Report Recommendations by Fiscal Year

	Total	**2011**	**2010**	**2009**	**2008**	**2007**
Implemented	59	31	15	10	3	-
Partially Implemented	42	13	14	9	4	2
Not Implemented	6	2	4	-	-	-
Deferred	10	8	1	1	-	-
Not Applicable	3	2	1	-	-	-
Total	**120**	**56**	**35**	**20**	**7**	**2**