STATE OF COLORADO
OFFICE OF THE STATE AUDITOR

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State Auditor

REPORT SUMMARY

STATE OF COLORADO
STATEWIDE SINGLE AUDIT
FISCAL YEAR ENDED JUNE 30, 2006

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 March through December 2006.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the fiscal year ended June 30, 2006.

- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2006.

- Review internal accounting and administrative control procedures as required by generally accepted auditing standards and generally accepted government auditing standards.

- Evaluate compliance with applicable state and federal laws, rules, and regulations.

- Evaluate progress in implementing prior audit recommendations.

We expressed an unqualified opinion on the State's financial statements for the fiscal year ended June 30, 2006. Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2006, which is available in hard copy from the Office of the State Controller and electronically at www.colorado.gov/dpa/dfp/sco/cafr/cafr06/cafr06.htm.

We issued a report on the State's compliance with internal controls over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards.* We noted matters involving the internal controls over financial reporting and its operation that we consider to be reportable conditions and material weaknesses.

- As defined by *Government Auditing Standards*, reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Colorado's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 1-30, 54, 57-63, 65-68, and 81-82.

- As defined by *Government Auditing Standards*, 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. Material weaknesses are described in the accompanying schedule of findings and questioned costs as Recommendation No. 28.

We also issued a report on the State's compliance with requirements applicable to each major program and internal controls over compliance in accordance with OMB *Circular A-133*. 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.

- We determined the State did not comply with requirements regarding Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, and Subrecipient Monitoring that are applicable to the Food Stamps Cluster (CFDA Nos. 10.551 and 10.561), Vocational Education Basic Grants to States (CFDA No. 84.048), Temporary Assistance for Needy Families (CFDA No. 93.558), State Children's Insurance Program (CFDA 93.767), Medicaid Cluster (CFDA Nos. 93.775, 93.777, and 93.778), and the Homeland Security State Domestic Preparedness Equipment Support (CFDA No. 97.067) program. Compliance with such requirements is necessary to meet requirements applicable to those programs. Material noncompliance associated with the above mentioned programs is described in the accompanying schedule of findings and questioned costs as Recommendations Nos. 32, 54, 74-84, and 88.

- We noted certain matters involving the internal control over compliance and its operation, in accordance with OMB *Circular A-133*, that we consider to be reportable conditions and material weaknesses. Reportable conditions and material weaknesses are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 31-33, 37-50, 61, 64, 72-85, 87-88, and 90-91, and Recommendation Nos. 32-33, 49-50, 72, and 74-84, respectively.

Current Year Findings and Recommendations

This report presents the results of the Statewide Single Audit for Fiscal Year 2006. 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 Single Audit Act, this report includes all findings and questioned costs related to federal awards that came to our attention through either the Statewide Single Audit or other audits.

As part of our Statewide Single Audit, we examined, on a test basis, evidence supporting the amounts and disclosures in the State's financial statements. We considered the internal control over financial reporting; tested compliance with certain provisions of federal and state laws, regulations, contracts, and grants; and tested account balances and transactions for proper financial reporting.

The following presents highlights of findings included in our report. The Recommendation Locator, following the Summary of Auditor's Results, includes a complete listing of all recommendations, agency responses, and implementation dates, as well as references to the location of each recommendation in the report.

Internal Controls

Agencies are responsible for having adequate controls in place to ensure compliance with laws and regulations and with management's objectives. As part of our audit, we tested controls over the processing of transactions and accounting for financial activity and identified the need for improvements in the following areas:

- Three agencies did not have adequate controls over payroll. The Department of Human Services inconsistently calculated leave without pay deductions. At the Department of Natural Resources, in some instances time sheets were either not approved by a supervisor, not signed by the employee, or were certified prior to the end of the pay period. The Department of Personnel & Administration overpaid employees in 16 percent of the payroll adjustments tested during Fiscal Year 2006.

- Internal control weaknesses were identified at the Department of Human Services in the areas of recording revenue for the state mental health institutes, exhibit preparation, purchasing cards, and employee travel reimbursements.

- The Department of Labor and Employment did not ensure Unemployment Insurance tax refunds were processed timely. We identified tax refunds that were not issued until 3 to 19 months after a taxpayer request had been filed.

- The Department of Personnel and Administration did not have sufficient access and security controls in place over the State's mainframe or electronic employee benefits system. In addition, the Department did not ensure that termination data in the State's payroll system and the benefits system was synchronized.

Financial Reporting

State agencies are responsible for reporting financial activity accurately and completely. The Office of the State Controller (OSC) establishes standard policies and procedures that must be followed by state agencies and institutions. As part of our audit, we reviewed the policies and procedures related to financial reporting that were in place at the agencies and institutions and tested a sample of financial transactions to ensure that controls were adequate and financial activity was reported properly. We found:

- The Department of Transportation lacked adequate internal controls over financial reporting of capital assets. Eleven prior period adjustments were proposed to correct capital asset balances and other capital asset transactions. These adjustments resulted in net increases to construction in progress, land, and infrastructure of $18.3 million, $10.2 million, and $13 million, respectively, and decreases to expenditures of $153.9 million.

- The Department of Health Care Policy and Financing continued to have problems with ensuring adequate internal controls over reporting of financial data. The Department had not fully reconciled accounts receivable of about $4 million to the subsidiary ledger and did not calculate an estimate for uncollectible accounts related to the Department's drug rebate program. In addition, the Department changed its methodology for calculating "incurred but not reported" (IBNR) claims without providing adequate supporting documentation for the change in methodology. The Department recorded IBNR claims of $152.3 million at June 30, 2006; this amount would have been $14.3 million higher if the methodology had remained the same.

- The Department of Regulatory Agencies did not follow generally accepted accounting principles and circumvented the Legislature's appropriation process when it failed to record nearly $69,000 in revenue and expenditures for contributed services on the State's accounting system.

- Three Departments failed to ensure capital assets were appropriately recorded on the State's accounting system, COFRS. The Departments of Natural Resources and Personnel & Administration did not capitalize assets valued at approximately $194,000 and $1.3 million, respectively. Further, the Department of Human Services booked asset entries in error at four of the six nursing homes, netting to $1.26 million.

Federal Grants

The State expended nearly $6 billion in federal grants in Fiscal Year 2006. As part of our audit, we determined compliance with federal regulations and grant requirements. Among other requirements, we tested for activities allowed or unallowed, allowable costs, cash management, eligibility, reporting, and subrecipient monitoring.

Colorado Benefits Management System (CBMS): For Fiscal Year 2006 we evaluated transactions processed by CBMS through review of three federal programs. Two programs are overseen by the Department of Human Services (DHS): Temporary Assistance for Needy Families (TANF) and Food Stamps. The other program, Medicaid, is overseen by the Department of Health Care Policy and Financing. We reviewed the Departments' procedures for complying with federal requirements for determining whether individuals are eligible to receive Food Stamps, TANF, and Medicaid. For all three programs we found significant error rates. For TANF and Medicaid, the error rates were higher than those identified in our Fiscal Year 2005 audit. For all three programs, the error rates found in our Fiscal Year 2006 audit continue to be unacceptably high because of the size of these programs and the risk of substantial federal disallowances. We found the following:

- For TANF, we found that 23 of the 60 payments in our random sample (38 percent of payments sampled) contained at least one error. For the 23 payments containing at least one error, we identified questioned costs of $4,540 out of the total sampled costs of $13,820 (33 percent of costs). These error rates are higher than those identified during our Fiscal Year 2005 audit. Specifically, during our Fiscal Year 2005 audit we identified a payment error rate of 25 percent and a dollar error rate of 20 percent for the sample tested. Total TANF benefit payments for Fiscal Year 2006 were $198 million, and the average monthly caseload was 14,930.

- For Food Stamps, we found that 11 of the 60 payments in our random sample (18 percent) contained at least one error. For the 11 payments containing at least one error, we identified questioned costs of $933 out of the total sampled costs of $10,809 (9 percent of costs). These error rates are lower than those identified during our Fiscal Year 2005 audit. Specifically, during our Fiscal Year 2005 audit we identified a payment error rate of 72 percent and a dollar error rate of 20 percent for the sample. Total Food Stamps benefit payments for Fiscal Year 2006 were $332 million, and the average monthly caseload was 107,581.

- For Medicaid, we found that 23 of the 51 payments in our random sample (45 percent) contained at least one error. For the 23 payments containing at least one error, we identified questioned costs of $36,590 out of the total sampled costs of $100,838 (36 percent). These error rates are higher than those identified during our Fiscal Year 2005 audit. Specifically, during our Fiscal Year 2005 audit we identified a payment error rate of 41 percent and a dollar error rate of 29 percent for the sample tested. Total Medicaid expenditures were over $3.2 billion for Fiscal Year 2006.

Medicaid: The Medicaid program is the State's largest federal program. During Fiscal Year 2006, Medicaid expenditures for administration and claims paid at HCPF totaled about $3.2 billion (state and federal funds). In addition to the error rates noted above we found significant problems with the management of the Medicaid and Children's Basic Health Plan programs:

- The Department could not ensure that about $2.3 million in Medicaid expenditures were first charged to the Medicare program, because it had not updated certain procedure codes within the Medicaid Management Information System (MMIS) for specific Medicare-covered services since July 2002. For clients who are dual eligible for both Medicare and Medicaid, federal regulations require that Medicaid is the payer of last resort.

- The Department did not adequately verify that providers who are providing services to Medicaid clients are licensed to participate in the program. In four of 10 cases tested, the Department did not have updated licenses recorded for the providers in MMIS.

- The Department has not generated outpatient hospital cost reports timely. This has created a backlog in the performance of outpatient hospital cost report audits. The backlog increased from 108 reports in Fiscal Year 2005 to 126 reports in Fiscal Year 2006. As a result, the Department does not know the amount of funds due to the State from providers, or if funds are due from providers to the State.

Homeland Security: The Department of Local Affairs expended nearly $19.2 million in federal funds for the administration of the Homeland Security Grant Program in Fiscal Year 2006. We continue to identify concerns with the Department's oversight of the program. We tested a sample of 40 reimbursements and found at least one error with 30 reimbursements, or 75 percent, and identified a total of $19,550 in questioned costs. We found that the Department was not adequately ensuring purchases and reimbursements were supported by sufficient documentation, subrecipient expenditures occurred prior to reimbursement requests, and that unallowable costs were not charged to the grant.

Student Financial Aid: State higher education institutions disbursed out about $839 million in student loans and grants in Fiscal Year 2006. We found the following problems at various state institutions:

- At six institutions adequate controls were not in place to prevent overpayments to students receiving financial aid and to ensure the return of federal funds in cases where students withdrew from school. We noted cases in which the institutions did not perform calculations timely and therefore, did not return funds or overpaid funds in violation of federal regulations.

- At two institutions, controls over subrecipient monitoring were lacking to ensure federal funds were expended in accordance with federal guidelines. We noted that the institutions were not ensuring that subrecipients expending over $500,000 in federal awards were being audited under the requirements of OMB *Circular A-133.*

- The Community College System's (System) administration of the Carl D. Perkins Vocational and Applied Technology Education Act and the Colorado Vocational Act lacked adequate controls to ensure programs offered by school districts and post-secondary institutions met and maintained compliance with applicable state and federal requirements. Specifically, we noted that the System did not ensure funding was discontinued for expired programs, federal matching requirements were not adhered to for the Perkins program, time sheets were not maintained for employees paid in part with federal funds, and subrecipients were not adequately monitored.

Communication of Audit-Related Matters

There were no unusual or significant matters reported in connection with the audit of the State of Colorado for the year ended June 30, 2006. Uncorrected misstatements identified during the Fiscal Year 2006 audit were determined by management and the Office of the State Auditor to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole. The net effect of the uncorrected misstatements would have been to increase the net assets by nearly $360,000, increase assets by about $3 million, decrease liabilities by nearly $12 million, decrease revenue by over $4.4 million, and increase expenditures by nearly $15.5 million. Appendix B shows the net and gross passed audit adjustments by agency and the net and gross posted audit adjustments by agency. A full disclosure of communications required under generally accepted auditing standards can be found in the Required Communications section.

Recommendation Locator

The Recommendation Locator following this summary is arranged by department. In addition, Appendix A contains a separate Locator with additional columns to provide the information necessary to meet Single Audit reporting requirements. The Catalog of Federal Domestic Assistance (CFDA) No./Compliance Requirement/Federal Entity column indicates the federal program, category of compliance requirement, and applicable federal agency. The contact for the Corrective Action Plan designates the state agency contact person. For those findings not subject to reporting under the Single Audit Act, the CFDA No./Compliance Requirement/Federal Entity column is marked "not applicable."

Summary of Progress in Implementing Prior Recommendations

This report includes an assessment of the disposition of prior audit recommendations reported in the previous Statewide Single Audit Reports. Prior years' recommendations that were implemented in Fiscal Year 2005 or earlier are not included.

Statewide Single Audit Reports by Fiscal Year						
	Total	**2005**	**2004**	**2003**	**2002**	**2001**
Implemented	56	44	12	-	-	-
Partially Implemented	56	33	15	4	2	2
Not Implemented	12	9	1	1	1	-
Deferred	12	11	-	-	1	-
Ongoing	3	-	2	1	-	-
In Progress	-	-	-	-	-	-
No Longer Applicable	1	-	1	-	-	-
Total	**140**	**97**	**31**	**6**	**4**	**2**