STATE OF COLORADO
OFFICE OF THE STATE AUDITOR **REPORT SUMMARY**

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State Auditor

STATE OF COLORADO
STATEWIDE SINGLE AUDIT
FISCAL YEAR ENDED JUNE 30, 2007

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 2007.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the fiscal year ended June 30, 2007.

- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2007.

- 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 have issued three reports in connection with our audit. First, we issued an unqualified opinion on the State's financial statements for the fiscal year ended June 30, 2007. Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2007, which is available in hard copy from the Office of the State Controller and electronically at www.colorado.gov/dpa/dfp/sco/CAFR/cafr07/cafr07.htm.

Second, 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.* These standards and Statement on Auditing Standards No. 112 (SAS 112) are established by the American Institute of Certified Public Accountants (AICPA) and require that we communicate

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matters related to the State's internal control over financial reporting identified during our audit of the State's financial statements. The standards define three levels of internal control weaknesses that must be reported. These are described below.

- A *control deficiency* is the least serious level of internal control weakness. A control deficiency 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 misstatements on a timely basis. Control deficiencies are reported in the accompanying schedule of findings and questioned costs as Recommendation Nos. 1-3, 7, 13-15, 21-24, 27-29, 32, 37-40, 42-45 and 108.

- A *significant deficiency* is a higher level of internal control weakness. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. Significant deficiencies are reported in the accompanying schedule of findings and questioned costs as Recommendation Nos. 4-6, 8-12, 16-18, 20, 25, 26, 30, 31, 33-36, 46, 47, 56, 67, and 79.

- A *material weakness* is the most serious level of internal control weakness. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. We did not note matters involving the internal controls over financial reporting and its operation during our audit that we consider to be material weaknesses.

Prior to each recommendation in this report, we have indicated the classification of each finding.

The third report we issued is a 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 with matters identified during our audit of the State's internal control over the financial reporting, we are required to communicate internal control issues related to each of the major federal programs in similar manner. These three levels of internal control weaknesses over major federal programs are as follows:

- A *control deficiency* is the least serious of level of internal control weakness. A control 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. Control deficiencies are reported in the accompanying schedule of findings and questioned costs as Recommendation Nos. 48, 61, 63-66, 69, 71-73, 76, 78, 95, 97, 108, 109, 111, 112, and 115-119.

- A *significant deficiency* is a higher level of internal control weakness. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. Significant deficiencies are reported in the accompanying schedule of findings and questioned costs as Recommendation Nos. 49-60, 62, 67, 68, 70, 74, 75, 79-94, 98, 99, 101-106, 110, 113, 114, and 120-122.

- A *material weakness* is the most serious level of internal control weakness. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Material weaknesses are reported in the accompanying schedule of findings and questioned costs as Recommendation Nos. 50-57, 59, 62, 67, 68, 70, 74, 80, and 86-90.

Prior to each recommendation in this report, we have indicated the classification of each finding.

During our testing of compliance with federal requirements, we determined the State did not comply with requirements regarding Activities Allowable and Unallowable Allowable Costs/Cost Principles, Eligibility, and Subrecipient Monitoring that are applicable to the Food Stamps Cluster (CFDA Nos. 10.551 and 10.561); Eligibility and Special Tests and Provisions that are applicable to the Federal Family Education Loans (CFDA No. 84.032) and Federal Pell Grant Program (CFDA No. 84.063); Subrecipient Monitoring that is applicable to the Vocational Education Basic Grants to States program (CFDA No. 84.048); Eligibility that is applicable to the Temporary Assistance for Needy Families (CFDA No. 93.558) and State Children's Insurance Programs (CFDA No. 93.767); and Activities Allowable and Unallowable; Allowable Costs/Cost Principles; Cash Management; Eligibility; Procurement, Suspension, and Debarment; and Subrecipient Monitoring that are applicable to the Medicaid Cluster (CFDA Nos. 93.777 and 93.778). 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. 50-57, 59, 62, 67, 68, 70, 74, 80, and 86-90.

Current Year Findings and Recommendations

The Statewide Single audit report presents our financial and compliance audit of the State of Colorado for Fiscal Year 2007. 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.

As part of our 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 section 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

State 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:

- Seven agencies did not have adequate controls over payroll and/or human resource-related functions during Fiscal Year 2007. The Department of Education did not ensure that compensation adjustments were appropriately documented and approved. At the Department of Health Care Policy and Financing, payroll reconciliations were not performed between August 2006 through May 2007. The Department of Human Services did not ensure that contracts were fully executed prior to making payments, or that signing bonuses were paid timely and failed to recoup one signing bonus when the employee left employment. As in Fiscal Year 2006, time sheets at the Department of Natural Resources were lacking employee certifications. At the Department or Personnel & Administration, 9 percent of the payroll adjustments tested were incorrect. The Department of Transportation failed to pay $148,000 in overtime earned between November 2006 through January 2007.

- The Departments of Corrections, Human Services, and Revenue lacked sufficient controls over purchasing cards. Specifically, the Department of Corrections did not ensure transactions totaling $2,000 were approved. At the Department of Human Services, 28 percent of the transactions tested contained at least one error, including account coding errors and lack of required signatures on cardholder statements. At the Department of

Revenue, 10 percent of cardholder files did not contain documentation required to issue purchasing cards to employees.

- Two agencies' internal controls over travel expenditures were inadequate. Transactions tested at the Departments of Public Safety and the Colorado Historical Society showed error rates of 20 percent and 76 percent, respectively. Some of the problems identified were transactions that were recorded in the wrong fiscal year, expenditures incorrectly coded, reimbursements lacking sufficient supporting documentation, and a reimbursement including entertainment and alcoholic beverages, both of which are prohibited under State Fiscal Rules.

- The Departments of Health Care Policy and Financing, Human Services, Personnel & Administration, and Transportation did not have sufficient physical and security controls in place over critical computer systems, including the State's financial and reporting system, COFRS; the State's electronic employee benefits system, Benefitsolver; the State's eligibility system for public and medical assistance, the Colorado Benefits Management System (CBMS); and the Department of Transportation's Systems, Applications, and Products system, SAP. In addition, the Department of Revenue did not have sufficient controls in place to ensure that terminated employees' access to the Department's mainframe and network was appropriately removed.

- The Department of Revenue had internal control weaknesses in the areas of duplicate tax refunds, modifications to taxpayer accounts, and physical security over refund warrants and certain types of taxpayer payments.

Financial Reporting

State agencies are responsible for reporting financial activity accurately, timely, 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 agencies' and institutions' control processes, policies, and procedures related to financial reporting and tested a sample of financial transactions to ensure that controls were adequate and financial activity was reported properly. We found:

- The Department of Human Services could not reconcile an approximately $5 million difference at fiscal year end between amounts due to or due from the counties recorded on the State's accounting system, COFRS, and amounts recorded on the Department's County Financial Management System, CFMS.

- At the Department of Health Care Policy and Financing, controls were lacking over financial reporting to ensure over $1.5 million in drug rebate and family planning receipts were allocated to the correct accounting period during the fiscal year.

- The Department of Local Affairs did not appropriately record accounts payable amounts for approximately $2 million in expenditures incurred in Fiscal Year 2007 but not paid until Fiscal Year 2008, although sufficient documentation was available prior to the end of Fiscal Year 2007.

Federal Grants

The State expended approximately $6.1 billion in federal grants in Fiscal Year 2007. 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 2007 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 individuals' eligiblility to receive Food Stamps, TANF, and Medicaid. For all three programs we found significant error rates. For Food Stamps, the error rates were higher than those identified in our Fiscal Year 2006 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 13 of the 60 payments in our random sample (22 percent of payments sampled) contained at least one error. For the 13 payments containing at least one error, we identified questioned costs of $1,831 out of the total sampled costs of $16,444 (11 percent of costs). These error rates are lower than those identified during our Fiscal Year 2005 and 2006 audits (Fiscal Year 2006: Payment error rate of 38 percent and dollar error rate of 33 percent for the sample tested; Fiscal Year 2005: Payment error rate of 25 percent and dollar error rate of 20 percent for the sample tested). Total TANF benefit payments for Fiscal Year 2007 were $59.1 million, and the average monthly caseload was 11,898.

- For Food Stamps, we found that 34 of the 60 payments in our random sample (57 percent) contained at least one error. For the 34 payments containing at least one error, we identified questioned costs of $2,922 out of the total sampled costs of $13,692 (21 percent of costs). These error rates are higher than those identified during our Fiscal Year 2006 audit, but lower then our Fiscal Year 2005 audit (Fiscal Year 2006: Payment error rate of 18 percent and dollar error rate of 9 percent for the sample tested; Fiscal Year 2005: Payment error rate of 72 percent and dollar error rate of 20 percent for the sample tested). Total Food Stamps benefit payments for Fiscal Year 2007 were $317 million, and the average monthly caseload was 107,355.

- For Medicaid, we found that 22 of the 60 payments in our random sample (37 percent) contained at least one error. For the 22 payments containing at least one error, we identified questioned costs of $12,170 out of the total sampled costs of $80,763 (15 percent). These error rates are lower than those identified during our Fiscal Year 2005 and 2006 audits (Fiscal Year 2006: Payment error rate of 45 percent and dollar error rate of 36 percent for the sample tested; Fiscal Year 2005: Payment error rate of 37 percent and dollar error rate of 15 percent for the sample tested). Total Medicaid expenditures were about $3.3 billion for Fiscal Year 2007.

Medicaid: The Medicaid program is the State's largest federal program. During Fiscal Year 2007, Medicaid expenditures for administration and claims paid by HCPF totaled about $3.3 billion (state and federal funds). In addition to the error rates noted above we found significant problems with the management of the Medicaid program.

- The Department did not ensure adequate follow-up to errors noted during its federally mandated Medicaid Eligibility Quality Control process. Of 39 Medical Assistance (MA) sites reviewed, the Department failed to receive responses to errors noted for 22 sites.

- Federal regulations require the primary recipient of federal funds to ensure subrecipients are in compliance with federal requirements. The Department did not ensure that 6 of 23 Single Entry Points (SEP) submitted corrective action plans for deficiencies cited during on-site reviews. Further, for the remaining 17 SEPs that did submit corrective action plans, the Department did not conduct follow-up reviews to determine if the plans had been put in place.

Children's Basic Health Plan: During Fiscal Year 2007, the Department of Health Care Policy and Financing expended $103 million in state and federal funds for the State Children's Health Insurance Program (SCHIP), referred to as the Children's Basic Health Plan or the Children's Health Plan Plus (CHP+) in Colorado. The purpose of this program is to provide health insurance to uninsured children 18 years and younger from low-income families who do not qualify for Medicaid. We identified the following areas in which the Department needs to improve controls over SCHIP.

- The Department needs to strengthen controls over compliance with federal grant requirements in the following areas: allowable costs, eligibility, program income, federal reporting, and subrecipient monitoring.

- The Department did not review the annual cash management agreement between the State Treasury and the federal Treasury to ensure the Department was requesting federal reimbursement in accordance with the Cash Management Improvement Act. By not performing this review, the Department was unaware that it should request reimbursement 5 days after the expenditure incurred, rather than the 4 days it was using for reimbursement requests during Fiscal Year 2007.

- The Department did not maintain effective fiscal controls over the preparation and submission of the federal report used to account for all federal cash received by the Department. For the report submitted for the quarter ended December 31, 2006, the Department excluded about $669,000 of SCHIP disbursements it received.

Foster Care Program: During Fiscal Year 2007, the Department of Human Services expended approximately $379 million at the state and local level on child welfare services. This includes about $65 million for out-of-home placements and about $46 million for Core Services, which are designed to prevent or shorten out-of-home placements. Of the $379 million expended, federal funds represent about 29 percent of the State's child welfare expenditures.

- 103 of 128 foster parent files reviewed were missing documentation to show that foster parents had fulfilled all training requirements, passed criminal history checks, and were involved in family case planning.

- The Department did not ensure adequate oversight of abuse or neglect investigations at the county departments of human/social services. If the Department disagrees with a county's investigation conclusion, the Department does not routinely take action to resolve disagreements. The Department also did not ensure that the counties cited with investigational deficiencies implemented recommendations for the county to reevaluated its conclusions.

- Questioned costs in the amount of $69,600 were identified at eight Child Placement Agencies (CPAs) because the expenditure were unreasonable, unallowable, or not supported by adequate documentation. Further, CPAs did not pass along the correct child maintenance payment to foster parents, as required by Department regulations. For 68 of 255 foster parents sampled, payments did not match the contracted amounts between the counties and CPAs.

Student Financial Aid: State higher education institutions disbursed about $542.6 million in student loans and grants in Fiscal Year 2007. We found the following problems at various state institutions:

- The Colorado Community College System (CCCS) during Fiscal Year 2007 expended approximately $111.2 million and $22.7 million on the Student Financial Aid Cluster and the Carl Perkins Vocational Education Program, respectively, and did not ensure adequate controls over a number of federal requirements for the administration of these programs.

    > CCCS lacked controls to ensure subrecipients of the Carl Perkins Vocation Education Program were in compliance with federal regulations. Further, sufficient documentation was not maintained for one employee's salary that was charged in part to the program.

> CCCS did not ensure compliance with federal regulations related to the Student Financial Aid Cluster in the following areas: Return of Title IV funds for withdrawing students, verification of information provided by students applying for federal student aid, providing exit counseling for graduating students or students enrolled half-time or less, tracking satisfactory academic progress, and eligibility.

- Western State College does not have a formal written policies and procedures manual for administering approximately $8.6 million in federal student financial assistance programs.

Communication of Audit-Related Matters

There were no unusual or significant audit-related matters to report in connection with the audit of the State of Colorado for the year ended June 30, 2007. Uncorrected misstatements identified during the Fiscal Year 2007 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 decrease the net assets by nearly $2 million, increase assets by about $300,000, increase liabilities by nearly $6.2 million, decrease revenue by over $708,000, and decrease expenditures by nearly $1.4 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 of this report.

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 2006 or earlier are not included.

Outstanding Statewide Single Audit Report Recommendations by Fiscal Year							
	Total	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**
Implemented	44	30	7	3	3	1	-
Partially Implemented	56	41	9	4	-	2	1
Not Implemented	7	3	1	-	1	-	1
Deferred	12	12	-	-	-	-	-
Implemented and Ongoing	16	3	8	5	-	-	-
No Longer Applicable	-	-	-	-	-	-	-
Total	**135**	**89**	**25**	**12**	**4**	**3**	**2**