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, 2008

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 2008.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the fiscal year ended June 30, 2008.

- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2008.

- 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 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, 2008. Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2008, which is available in hard copy from the Office of the State Controller and electronically at http://www.colorado.gov/dpa/dfp/sco/CAFR/cafr08/cafr08.htm.

Second, we issued a report on the State's compliance with internal control 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) issued by the American Institute of Certified Public Accountants (AICPA) 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, 5, 6, 16, 25-29, 37-41, 45-49, and 61.

- 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, 7-15, 17, 18, 20-24, 30-36, 42-44, 51-53, 63, 64, and 67.

- 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 control 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 the 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 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 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. 61,68-70, 74, 75, 77, 78, 80, 90-92, 94, 97, 100, 105-107.

- 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 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. 53-60, 62-67, 71, 73, 76, 79, 81-89, 93, 95, 96, 98, 99, 101-104, and 109.

- 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 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. 53, 55-57, 59, 60, 62-64, 76, 81, 83, 84, and 86-88.

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

During our testing of compliance with federal requirements, 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); 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); Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, and Subrecipient Monitoring that are applicable to the Temporary Assistance for Needy Families (CFDA No. 93.558); Eligibility and Subrecipient Monitoring that are applicable to the State Children's Insurance Programs (CFDA No. 93.767); and Activities Allowed or Unallowed; Allowable Costs/Cost Principles; Eligibility; Subrecipient Monitoring; and Special Tests and Provisions 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. 53, 55, 56, 60, 62, 64, 79, 81, 83, 84, and 86-88.

Current Year Findings and Recommendations

The Statewide Single Audit report presents our financial and compliance audit of the State of Colorado for Fiscal Year 2008. 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:

- The Departments of Human Services, Military and Veterans Affairs, Natural Resources, and Revenue lacked sufficient controls over purchasing cards. Specifically, at the Department of Human Services, 29 percent of the transactions tested contained at least one error, including coding errors and lack of required signatures on cardholder statements. At the Department of Military and Veterans Affairs, 12 percent of the monthly purchasing card statements lacked evidence of supporting documentation for purchases. At the Department of Natural Resources, 24 percent of the transactions tested contained at least one error, including employees splitting purchases into multiple transactions to circumvent their card limits. In 6 percent of the sampled cardholders at the Department of Revenue, required signatures were absent on cardholder account forms and monthly statements.

- Four agencies' internal controls over travel expenditures were inadequate. Transactions tested at the Departments of Human Services, Public Safety, and Regulatory Agencies, as well as the Colorado Historical Society showed a combined error rates of 37 percent. Some of the problems identified were reimbursements lacking sufficient supporting documentation, to employees claiming excess mileage reimbursements, and coding errors.

- The Office of the Governor, and the Departments of Health Care Policy and Financing, Human Services, Personnel & Administration, and Revenue, did not have sufficient physical and user access controls in place over the State's mainframe and critical computer systems including the State's payroll system, the State's eligibility system for public and medical assistance, the Colorado Benefits Management System, the State's public assistance electronic benefits distribution system, the Medicaid Management Information System, and the Department of Revenue's tax and refund systems.

- The Department of Revenue had internal control weaknesses related to severance tax refunds, cash, data security, and electronic funds transfers.

- Four agencies did not have adequate controls over the preparation of year-end exhibits. The Office of the Governor and the Departments of Human Services, Military and Veterans Affairs, and Revenue's exhibits contained errors and/or omissions when submitted to the Office of the State Controller. These exhibits are necessary to ensure appropriate disclosures are made in the State's annual financial statements.

- Four agencies did not have adequate payroll controls. At the Department of Human Services 18 percent of the 120 payroll adjustments tested identified over- and under-payments, as well as delayed payments to employees. At the Department of Natural Resources time sheet calculation errors resulted in payment errors, questionable information on time sheets, and an overall lack of controls related to hourly payroll. The Department of Personnel & Administration's payroll review process failed to catch payroll adjustment errors. The Department of Local Affairs did not correctly allocate employee payroll expenses to the appropriate programs.

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 continues to be unable to reconcile differences 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. During our Fiscal Year 2008 audit the difference was approximately $3.3 million.

- At the Department of Health Care Policy and Financing, inadequate controls caused the allowance for doubtful accounts to be understated and total assets to be overstated by $1.1 million on the State's financial statements.

- The Department of Labor and Employment is unable to verify the accuracy of the unemployment insurance tax refund balance of approximately $24 million. The balance increased nearly $10 million from prior year.

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- The Departments of Human Services and Military and Veterans Affairs failed to fully record $1 million and $2.1 million, respectively, in completed building projects to the appropriate asset account on COFRS in a timely fashion.

- The Department of Transportation failed to review all fiscal year-end deferred revenue balances, which caused a $7.4 million overstatement on COFRS. The Department submitted a correcting entry to the Office of the State Controller prior to the issuance of the State's financial statements.

Federal Grants

The State expended approximately $6.6 billion in federal grants in Fiscal Year 2008. As part of our audit, we determined compliance with federal regulations and grant requirements, such as activities allowed or unallowed, allowable costs, cash management, eligibility, reporting, and subrecipient monitoring.

Colorado Benefits Management System (CBMS): For Fiscal Year 2008 we evaluated transactions processed by CBMS through review of four federal programs. Two programs are overseen by the Department of Human Services (DHS): Temporary Assistance for Needy Families (TANF) and Food Stamps. The other two programs, Medicaid and the Children's Basic Health Plan (CBHP), are 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, Medicaid and CBHP. For all four programs we found significant error rates. In general, these errors related to problems with the recipient's eligibility or the amount of the benefit issued.

- TANF/Colorado Works: We found that 17 of the 60 benefit payments in our sample (28 percent) contained at least one error. For these 17 payments we identified questioned costs of $1,195 out of the total sampled costs of $11,347 (11 percent of costs). Over the last four years, the payment error rate is the second highest and the dollar error rate remained the lowest, the same as in Fiscal Year 2007.