Summary

STATE OF COLORADO
STATEWIDE SINGLE AUDIT
FISCAL YEAR ENDED JUNE 30, 2010

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 2010.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the fiscal year ended June 30, 2010.

- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2010.

- 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 opinions in connection with our financial and compliance audit of the State for Fiscal Year 2010. First, we issued an unqualified opinion on the State's financial statements for the fiscal year ended June 30, 2010. Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2010, which is available electronically from the Office of the State Controller's website at http://www.colorado.gov/dpa/dfp/sco/CAFR/cafr10/cafr10.pdf.

The second and third opinions we have issued in connection with our Fiscal Year 2010 audit are included under Section V of this report. The second opinion we have issued is 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 (SAS 115) issued by the American Institute of Certified Public Accountants (AICPA) 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. The standards define three levels of internal control weaknesses that must be reported.

- 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 are reported in the accompanying Schedule of Findings and Questioned Costs as Recommendation Nos. 1-4, 9-10, 17-21, 24, 29-30, 33-42, 44-46, and 94.

- A *significant deficiency* is a higher 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. Significant deficiencies are reported in the accompanying Schedule of Findings and Questioned Costs as Recommendation Nos. 5-8, 11-16, 22-23, 25-28, 31-32, 43, and 73.

- 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. 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.

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

- *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. Deficiencies in internal control are reported in the accompanying Schedule of Findings and Questioned Costs as Recommendation Nos. 47-50, 52-54, 67-72, 76, 90, 93, 98-99, 102, and 106.

- A *significant deficiency* is a higher 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. Significant deficiencies are reported in the accompanying Schedule of Findings and Questioned Costs as Recommendation Nos. 51, 55-66, 74-75, 77-89, 91-92, 94-97, 100-101, 103-105, and 107-109.

- 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. Material weaknesses are reported in the accompanying Schedule of Findings and Questioned Costs as Recommendation Nos. 55-61, 78, and 107.

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 Matching, Level of Effort, Earmarking that is applicable to the Secure Payments for States and Counties Containing Federal Lands Program (CFDA No. 10.665); Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, and Subrecipient Monitoring that are applicable to the Supplemental Nutrition Assistance Program Cluster (CFDA Nos. 10.551 and 10.561); Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, Matching, Level of Effort, Earmarking, and Subrecipient Monitoring that are applicable to the Children's Health Insurance Program (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. 57-59, 62, 64-65, 78, and 107.

Current Year Findings and Recommendations

The Statewide Single Audit report presents our financial and compliance audit of the State of Colorado for Fiscal Year 2010. 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 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 internal 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 Department of Revenue had internal control weaknesses related to processing severance tax returns, income tax returns, tax edit reviews, and electronic funds transfers.

- Two agencies' internal controls over travel expenditures were inadequate. Overall the sample of transactions tested at the Department of Revenue and Department of State showed error rates of 18 and 48 percent, respectively. Problems identified included lack of sufficient supporting documentation, missing approvals, lack of timeliness, calculation errors, and coding errors.

- Internal controls over procurement card (P-card) expenditures were inadequate at three agencies. Overall the sample of transactions tested at the Departments of Natural Resources, Revenue, and Human Services showed error rates of 100 percent, 58 percent, and 27 percent, respectively. Problems identified included missing, late, or improper supervisor approval; incorrectly paying sales tax; split purchases; and incorrectly coded transactions.

- Three agencies did not have adequate payroll controls. At the Department of Agriculture 38 percent of the 120 time sheets tested were not properly certified by employees and/or supervisors. At the Department of Human Services five payroll adjustments were calculated incorrectly, resulting in over- and underpayments to employees ranging from $1 to $360; six personnel forms were not entered timely resulting in delayed payments to employees in several instances; and 19 time sheets were not certified timely. At the Department of State the payroll reconciliation failed to catch errors in five of the 31 payroll adjustments tested, resulting in an incorrect leave calculation, incorrect wage calculation, and missing approvals.

- Internal controls over cash were inadequate at three agencies. The Department of Labor and Employment did not draw federal funds down timely to cover expenses incurred during the period, resulting in a deficit cash balance of approximately $11.8 million as of June 30, 2010, that was covered through a loan from the State's General Fund. The Departments of Health Care Policy and Financing and Human Services were out of compliance with State Fiscal Rules that require checks to be deposited by the last day of the month. We found that four out of 27 (15 percent) cash receipt transactions tested at the Department of Health Care Policy and Financing and 23 out of 94 (24 percent) cash receipt transactions tested at the Department of Human Services were not deposited timely.

- Internal controls over revenue were inadequate at three agencies. At the Department of Health Care Policy and Financing we noted problems with the following: the recording and reconciliations of nursing facility provider fee revenue, improper classification of $1.4 million in TABOR revenue, and improper classifications of about $11.4 million as a credit against the current year's expenditures instead of as revenue. At the Department of Human Services we found that the Department did not prepare monthly and year-end reconciliations between its internal system and the State accounting system, COFRS, of Medicare Part D revenue and the related receivable information. We also noted incomplete reconciliations of revenue at the Fitzsimons, Florence, and Trinidad nursing homes. At the Department of Natural Resources, the State Land Board did not conduct detailed quarterly balance sheet account analysis, causing an overstatement of more than $3.8 million of the Department's asset and related revenue accounts at the end of Fiscal Year 2010.

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' 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 Health Care Policy and Financing lacked adequate controls over the financial reporting process, Medicaid payment liability calculation, and procedures for determining the reporting status of a new entity.

- 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. The difference between the two systems was approximately $1.7 million at June 30, 2010.

- The Department of Human Services lacked adequate controls over the preparation of year-end exhibits. Three of the 18 (17 percent) exhibits prepared by the Department of

Human Services 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.

- The Department of Labor and Employment's automated unemployment insurance tax system is unable to produce reports with sufficient detail to allow the validation of refunds owed to employers, and the Department lacks procedures to verify the $14 million liability account on COFRS.

Federal Grants

The State expended approximately $11.4 billion in federal grants in Fiscal Year 2010. 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. Our testing included approximately $2.6 billion expended under the federal American Recovery and Reinvestment Act of 2009 (Recovery Act). The three largest areas of Recovery Act expenditures for the State in Fiscal Year 2010 were $414 million for the Medicaid program, $480 million for the State Fiscal Stabilization Cluster, and $1.4 billion for the Unemployment Insurance program.

Federal American Recovery and Reinvestment and Act

Enacted in response to a significant slowdown in the American economy and increased unemployment nationwide, the Recovery Act became law. The Recovery Act's purpose is to:

- preserve and create jobs and promote economic recovery;
- assist those most affected by the recession;
- provide investments needed to increase economic efficiency by spurring technological advances in science and health;
- invest in transportation, environmental protection, and other infrastructure that will provide long-term economic benefits; and
- stabilize state and local government budgets to minimize and avoid reductions in essential services.

From its date of passage, in February 2009, through June 30, 2010, under the Recovery Act more than $218.6 billion has been awarded nationwide in federal contracts, grants, and loans. Colorado's share of this amount for the period is approximately $4.3 billion, with a majority of the funds, or $2.8 billion, awarded through new or existing federal grants. To ensure transparency and accountability over how the funds are invested, the federal Office of Management and Budget (OMB) issued guidance for implementation of the Recovery Act. As part of this guidance, OMB expanded audit requirements for entities that receive Recovery Act funds.

In August 2009 OMB designated programs that receive Recovery Act funds as "higher risk programs" and issued additional guidance for auditing those programs. For those programs, OMB also encouraged earlier reporting of significant deficiencies or material weaknesses related to compliance with federal requirements; these terms are defined earlier in this Summary. Specifically, for programs receiving Recovery Act funds, OMB encouraged auditors to report such deficiencies or weaknesses before the Single Audit deadline nine months after the end of the fiscal year. OMB first implemented this early reporting process in the fall of 2009 through the Single Audit Internal Control Pilot Project, Phase 1. Colorado was one of 16 states that volunteered to participate in Phase 1. In December 2009 we reported the Phase 1 results in *The American Recovery and Reinvestment Act of 2009 Internal Control Pilot Project Report*, Report No. 2047.

In August 2010 based on the results of Phase 1 and the continuing flow of Recovery Act funds, OMB announced the continuation of the Single Audit Internal Control Pilot Project as Phase 2 for the subsequent fiscal year. Requirements for Phase 2 are similar to Phase 1, except that Phase 2 requires that the State Auditor report on the results of the Single Audit work for at least four programs receiving Recovery Act funds, as opposed to the requirement to report on two programs in Phase 1. For Phase 2, the audit work must be completed by November 30, 2010, and the auditor must issue a report by December 31, 2010—three months earlier than the nine-month deadline specified by the Single Audit Act. Colorado was one of 12 states that volunteered to participate in Phase 2.

The Office of the State Auditor completed the *American Recovery and Reinvestment Act of 2009 Internal Control Pilot Project*, *Phase 2*, Report No. 2138, dated November 2010. The information and comments contained in the Pilot report are also included in this Statewide Single Audit report as Recommendation Nos. 83-92, 97-98, 102, and 104.

Federal Compliance

Colorado Benefits Management System (CBMS): For Fiscal Year 2010 we evaluated transactions processed by CBMS through review of four federal programs. Two programs are overseen by the Department of Human Services: Supplemental Nutrition Assistance Program (SNAP) and Temporary Assistance for Needy Families (TANF). 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' eligibility to receive SNAP, TANF, Medicaid, and CBHP. For three of the four programs we found error rates of 30 percent or more. Most of these errors related to problems with the recipient's eligibility or the amount of the benefit issued.

- **SNAP/Food Assistance:** 18 of the 60 case files in our sample (30 percent) contained at least one error. The errors related to caseworker entry of information, timely processing of redeterminations, and resolution of Income, Eligibility, and Verification System (IEVS) alerts. Seven (12 percent) of the 60 cases contained errors that resulted in total overpayments (questioned costs) of $1,836 and underpayments to the clients of $267. Total SNAP/Food Assistance benefit payments for Fiscal Year 2010 were nearly $664 million, and the average monthly caseload was 168,785.

- **TANF/Colorado Works:** 3 of the 40 benefit payments in our sample (8 percent) contained at least one error. The errors related to case file documentation, data entry, or follow up on an outstanding claim. All three cases contained errors that resulted in total overpayments (questioned costs) of $7,058 and underpayments to the clients of $44. Total TANF/Colorado Works benefit payments for Fiscal Year 2010 were nearly $78 million, and the average monthly caseload was 13,729.

- **Medicaid:** 26 of the 63 payments sampled (43 percent) contained at least one error. The errors related to case file documentation, data entry, and case discontinuance if the beneficiary became ineligible. For these 26 payments we identified questioned costs of about $7,205 out of the total sampled costs of $68,520 (11 percent). We identified an additional 8 errors from payments not included in our sample, resulting in another $26,823 in questioned costs. These payments were not included in our original sample of 63 payments but were paid to the recipients whose case files we reviewed as part of our original sample. The total amount of questioned costs for all errors found was $34,028.

- **CBHP:** 26 of the 60 case files sampled (43 percent) contained at least one error. The errors related to case file documentation, data entry, and case discontinuance if the beneficiary became ineligible. For these 26 case files with errors, we identified questioned costs of $9,724 out of the total sampled costs of $70,422 (14 percent). We identified an additional 10 errors in the reviewed cases, resulting in another $21,278 in questioned costs. These errors were not included in our original sample of 60 case files but were paid to the recipients whose case files we reviewed as part of our sample. The total amount of questioned costs for all errors found was $31,002.

Medicaid and CBHP: The Medicaid program is the State's largest federal program with expenditures for administration and claims paid by the Department of Health Care Policy and Financing totaling about $4.4 billion (state, federal, and Recovery Act funds) during Fiscal Year 2010. The Department of Health Care Policy and Financing expended about $182.3 million (state and federal funds) for the CBHP program during Fiscal Year 2010. In addition to the error rates noted above, we found significant problems with the management of the Medicaid program.

- The Department of Health Care Policy and Financing lacked adequate internal controls to ensure laboratories are certified under the federal Clinical Laboratory Improvement Amendment (CLIA) program prior to receiving payment from the Medicaid program.

- The Department of Health Care Policy and Financing continued to lack adequate controls over provider eligibility. Of the 85 providers we tested that were required to be licensed, for 16 (19 percent) providers current licensing information was not reflected in the

Medicaid Management Information System. Additionally, 10 of the 85 providers did not have provider participation agreements in the files.

- The Department of Health Care Policy and Financing lacked policies and internal controls over the process for calculating Family Planning expenditures and submitted about $1.2 million to the federal government at an incorrect reimbursement rate.

Student Financial Aid: State higher education institutions disbursed about $1.6 billion in student loans and grants in Fiscal Year 2010. We found the following problems at various state institutions:

- The Community College of Denver lacked adequate controls over payroll expenditures including approval of confirmation reports and a review of monthly and biweekly payroll, resulting in $57,000 being paid to one employee for duty assignments in addition to the employee's regular workload without proper approval, of which $28,600 was for nonteaching assignments charged to federal and private grants.

- Colorado State University and the Community College System lacked adequate controls to ensure the return of Title IV student financial aid funds was in compliance with federal requirements. Colorado State University also lacked sufficient review processes over the Fiscal Operations Report and Application to Participate (FISAP) report, which contains information related to the Student Financial Aid Cluster.

Federal Reporting

The Departments of Human Services and Labor and Employment failed to initially report expenditures correctly on the Exhibit K, which directly affects the State's Schedule of Expenditures of Federal Awards.

At the Department of Human Services, of the 26 federal reports we reviewed for various programs, 10 (38 percent) contained at least one error. The types of errors identified were related to completeness, accuracy, timeliness, supporting documentation, and overall compliance with federal requirements. Of the four federal reports we tested at the Governor's Energy Office for the Weatherization Program, all contained at least one error. The types of errors identified were related to completeness, accuracy, authorization, and overall compliance with federal requirements.

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, 2010. Uncorrected misstatements identified during the Fiscal Year 2010 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 $1.9 million, increase assets by about $3.7 million, decrease liabilities by nearly $24 million, increase revenue by about $16.3 million, and increase expenditures by about $2 million. Appendix VII - 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 Section VI. Required Communications.

Recommendation Locator

The Recommendation Locator following this summary is arranged by department. In addition, Appendix VII - 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 2009 or earlier are not included.

Outstanding Statewide Single Audit Report Recommendations by Fiscal Year

	Total	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
Implemented	61	49	3	8	-	-	1
Partially Implemented	94	67	19	6	1	1	-
Not Implemented	25	25	-	-	-	-	-
Deferred	9	9	-	-	-	-	-
Total	**189**	**150**	**22**	**14**	**1**	**1**	**1**

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