STATE ENERGY PROGRAM
COLORADO ENERGY OFFICE
OFFICE OF THE GOVERNOR

PERFORMANCE AUDIT
NOVEMBER 2014

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November 14, 2014

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the State Energy Program within the Colorado Energy Office. The audit was conducted pursuant to 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 Office of the State Auditor contracted with Two Hills Accounting & Consulting, P.C., to conduct this audit. The report presents our findings and conclusions.

Sincerely,

Jeanne Hill

Two Hills Accounting & Consulting, P.C.

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Colorado Energy Office

As a result of the oil crisis that occurred in the late 1970s, the U.S. Department of Energy (DOE) recovered more than $4 billion in overcharge fees from oil companies. DOE then earmarked the funds as restitution to the states to be used for various energy conservation grant programs. States interested in obtaining access to the earmarked funds through these federal grant programs were required to establish a dedicated state energy office. The Colorado Energy Office (CEO or Office), which is within the Governor's Office, was originally established in 1977 as the then Office of Energy Conservation.

Over the years, different gubernatorial administrations and the General Assembly have expanded and revised CEO's role in the State's energy economy and codified the Office in state statute (Section 24-38.5-101 et seq., C.R.S.). CEO now administers multiple state and federal programs, advises stakeholders on energy-related policy and legislation, and promotes Colorado's energy market development. Statutes specify, in part, that CEO is responsible for:

- Working with communities, utilities, and organizations to promote and advance renewable energy, such as wind, solar, and geothermal, and energy efficiency in the state.
- Promoting high-performance, energy efficient buildings in commercial and residential markets.
- Promoting technology transfer and economic development in the energy sector.
- Improving energy efficiency in public schools.
- Collaborating with higher education institutions to develop renewable energy curricula to serve workforce needs.

CEO is headed by a Director who reports to the Governor's Deputy Chief of Staff. The organization has undergone multiple reorganizations to accommodate new statutory requirements, directives from the Governor's Office, and funding adjustments over recent years, all of which have created ongoing strategic and operational changes. As of October 2014, CEO had 30 employees responsible for the management and administration of numerous energy-related programs, including the State Energy Program.

Overview of the State Energy Program

The federal Energy Policy and Conservation Act of 1975 established programs, including the State Energy Conservation Program, now known as the State Energy Program (SEP or Program), to foster conservation in federal buildings and major industries throughout the states. Understanding the history of the Program is important to understanding its funding, goals and objectives:

- During the 1980's, Petroleum Violation Escrow (PVE) monies provided funding for states to develop energy efficient practices. PVE monies were accrued from refunds paid by oil companies that had overcharged for petroleum and petroleum products. In addition to PVE funding, the 1986 Exxon and Stripper Well settlements provided more than $4 billion in additional overcharge refunds, a significant portion of which was allocated to energy programs.
- In the 1990's, the federal Energy Policy Act gave the Secretary of Energy the authority to provide funding to states to finance revolving funds for energy efficiency improvements in state and local government buildings and energy efficiency training for building designers and contractors. In 1996, SEP, as it is known today, was established through consolidation of the State Energy Conservation Program and the Institutional Conservation Program.
- More recently, Congress dramatically increased SEP funding. The American Recovery and Reinvestment Act of 2009 (Recovery Act) provided about $3 billion in SEP funding for state programs, $49.2 million of which was awarded to Colorado.

State Energy Program Funding

DOE is responsible for awarding energy funding to the states and territories. Under Title 10, Part 420 of the Code of Federal Regulations, DOE allocates SEP funding using a statutory formula that includes a minimum allocation plus an amount related to population and energy consumption. Colorado's base allocation, or core formula grant, for SEP funds is $399,000. This amount is awarded in every year that the available Congressional appropriation equals $25.5 million. In addition to the core formula grant, states may apply to DOE for SEP competitive grants and SEP special projects grants in years when funding is available. Finally, under the

Recovery Act, in 2009 CEO was awarded a total of about $49.2 million in funding for SEP programs.

DOE awards are generally provided on a multi-year basis and are intended to provide grantees, subrecipients, and contractors with monies to increase energy efficiency; reduce energy costs; improve the reliability of electricity, fuel, and energy services delivery; develop alternative and renewable energy resources; promote economic growth; and reduce the nation's reliance on imported oil. Thus, expenditures in any given year may comprise monies from grants awarded in prior years. The expenditures must occur within the performance period of the federal award, which was 3 years for the Recovery Act. In addition, expenditures may include monies from sources other than federal funds, for example state funds. From State Fiscal Years 2008 through 2010, SEP funding was awarded and expended as detailed in Exhibit 1-1.

Exhibit 1-1
Colorado Energy Office, State Energy Program Awards and Expenditures[1] by Project Area
State Fiscal Years 2008–2010

Project Area	2008		2009		2010		Total	
	Awarded	Expended	Awarded	Expended	Awarded	Expended	Awarded	Expended
Appliance Rebates[3]						$3,839,400		$3,839,400
Residential Rebates					$7,322,000	$2,476,600	$7,322,000	$2,476,600
Public Information[2]	$66,700	$74,200	$31,700	$29,900	$4,970,300	$1,582,000	$5,068,700	$1,686,100
Commercial Buildings			$81,500	$333,700	$6,001,500	$1,235,900	$6,083,000	$1,569,600
Residential Buildings[2]			$111,400	$319,900	$5,771,900	$843,300	$5,883,300	$1,163,200
Administrative Support[2]	$39,900	$47,900	$185,100	$229,700	$2,871,700	$878,600	$3,096,700	$1,156,200
Capital Investment					$17,974,100	$647,800	$17,974,100	$647,800
Colorado Carbon Fund[2]			$255,700	$227,400	$554,300	$390,300	$810,000	$617,700
Colorado Electric and Gas Utilities					$853,600	$202,500	$853,600	$202,500
Greening Government					$712,000	$165,100	$712,000	$165,100
Geothermal Support[2]	$142,200	$12,500	$82,700	$118,100			$224,900	$130,600
Codes and Standards[2]	$104,200	$116,200					$104,200	$116,200
Biofuels Dispersion[2]	$129,200	$107,600	$74,200	$5,200			$203,400	$112,800
Residential Program Consultants					$1,831,000	$103,900	$1,831,000	$103,900
Re-Energizing Colorado[2]	$83,300	$99,100					$83,300	$99,100
Efficiency Colorado Utility[2]	$189,600	$81,300					$189,600	$81,300
Anaerobic Digestion			$80,500	$73,400			$80,500	$73,400
Transmission					$388,800	$71,700	$388,800	$71,700
Biomass			$32,500	$62,100			$32,500	$62,100
Energy Emergency Planning[2]	$31,700	$37,300	$24,800	$21,700			$56,500	$59,000
Utility Issues[2]	$33,300	$37,500	$24,800	$20,200			$58,100	$57,700
Community Small Wind[2]	$27,000	$31,100	$23,100	$13,100			$50,100	$44,200
Assurance Plan[3]						$43,300		$43,300
Residential Education and Outreach					$525,000	$24,300	$525,000	$24,300
Woody Biomass[2]	$65,000	$11,300					$65,000	$11,300
Totals	**$912,100**	**$656,000**	**$1,008,000**	**$1,454,400**	**$49,776,200**	**$12,504,700**	**$51,696,300**	**$14,615,100**

Source: Two Hills Accounting & Consulting's compilation of CEO data.
[1]Expenditures can exceed federal awards due to the use of state funds. Awards represent amounts authorized in agreements with subrecipients and vendors.
[2]Expenditures include SEP Formula Grant, Recovery Act, and State Funds.
[3]Expenditures include SEP Formula Grant, Recovery Act, DOE Special Project, and State Funds.

Audit Purpose

This report contains the results of our performance audit of SEP expenditures and activities during State Fiscal Years 2008 through 2010. Work on this audit was performed from March 2014 to November 2014. We conducted this audit pursuant to 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 prompted by a legislative audit request submitted to the State Auditor as a result of deficiencies in key programmatic and fiscal controls identified in the Office of the State Auditor's (OSA) December 2012 *Colorado Energy Office Performance Audit*.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

CEO received and commented on a draft copy of this report, and we have incorporated CEO's comments into the final report where applicable and appropriate. We are grateful for the cooperation of CEO staff throughout the audit process. CEO staff were knowledgeable and professional, responded promptly to our requests for information, and provided thoughtful input and candid feedback.

Audit Scope and Objective

The objective of this performance audit was to determine if there is evidence that fraud, abuse, or waste occurred in SEP expenditures and activities during State Fiscal Years 2008 through 2010.

To provide context to the audit objective, we provide the following definitions:

- ***Fraud*** involves obtaining something of value through willful misrepresentation. Whether an act is, in fact, fraud is a determination to be made through the judicial system and is beyond auditors' professional responsibility.
- ***Abuse*** involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given

the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. The determination of abuse is subjective. Abuse does not necessarily involve fraud; however, abuse may represent the potential for fraud.

- ***Waste*** involves the needless, careless, or extravagant expenditure of funds, incurring unnecessary expenses, or mismanagement of resources or property. The determination of waste is subjective. Waste does not necessarily involve private use or personal gain, but typically signifies poor management decisions, practices, or internal controls.

Based on the legislative audit request, which was approved by the Legislative Audit Committee, the scope of this audit was limited to SEP expenditures and activities for State Fiscal Years 2008 through 2010. Consequently, the audit did not include any other aspects of CEO's programs, funding, or operations. The audit was not intended or designed to provide an assessment of the current status of CEO's internal controls over SEP expenditures and activities. Finally, although the federal grant award requirements were important for understanding the context of the Program, the audit was not intended or designed to test SEP expenditures and activities or report on compliance or internal control over compliance in accordance with the federal Office of Management (OMB) and Budget's *Circular A-133: Audits of States, Local Governments, and Non-Profit Organizations* or OMB's *Circular A-133 Compliance Supplement*.

We note that our test work and related conclusions are limited by the fact that the audit period covered SEP expenditures and activities occurring 4–7 years ago and, as a result, some CEO staff and documentation were no longer available. In areas where evidence was limited, we performed alternative procedures to develop a reasonable basis for our findings and conclusions. Specific limitations included:

- Most of the program and accounting staff knowledgeable about and responsible for the administration of SEP during the audit period, including CEO's controller at the time, are no longer with CEO. This turnover in program and accounting staff limited our ability to obtain and verify information about matters such as available expenditure documentation, procurement decisions, and subrecipient/contractor monitoring activities.

- State and subrecipient/contractor records were missing and/or not always well organized. The OSA's December 2012 *Colorado Energy Office Performance Audit* found that CEO had not established centralized systems and processes for organizing and maintaining programmatic documentation. Whenever possible, we worked around inadequate documentation and reviewed compensating documentation. For example, if documentation justifying payment was not in CEO files, we requested and reviewed progress reports and contacted various external sources to confirm that work had been completed.

- Testing documentation for the rebate program presented a particular challenge because the vendor that CEO hired to administer the rebate program during the audit period was recently sold to another company, making records retrieval challenging. At the conclusion of the program, unclaimed rebates were sent to the State unclaimed property fund and online access was discontinued. As a result, access to bank reconciliations was no longer available.

Audit Methodology

To accomplish our objective, we applied best practices established by the American Institute of Certified Public Accountants (AICPA), Association of Certified Fraud Examiners (ACFE), and the Institute of Internal Auditors (IIA). These best practices provide credible criteria and guidance from leading professional organizations that define principles and theories of fraud risk, fraud risk management, and fraud prevention and detection activities.

Risk Assessment

We began our audit with a risk assessment to identify areas where SEP might be vulnerable to fraud, abuse, or waste. The risk assessment included brainstorming sessions with members of the OSA audit team who conducted the December 2012 *Colorado Energy Office Performance Audit,* as well as subject matter experts (e.g., Certified Fraud Examiners, Certified Public Accountants, auditors, and staff knowledgeable about SEP. We discussed operations and activities susceptible to fraud and identified the most likely fraud schemes at the CEO and subrecipient/contractor levels. Our discussions included consideration of individuals' incentives or pressures to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could allow individuals to commit fraud. As such, we assessed weaknesses in internal controls designed to prevent or detect fraud; reviewed the oversight roles and responsibilities of CEO and SEP management; and evaluated the likelihood of management overrides of internal controls. We also interviewed CEO staff regarding strengths and weaknesses in internal controls in place during the audit period.

As part of the risk assessment process, we reviewed the results of recent financial and performance audits conducted by the OSA related to CEO and federal energy funding in

Colorado, as well as federal audits conducted by the DOE Inspector General related to state energy programs nationwide. These prior audits were instructive for understanding the control environment for CEO and SEP and helped us target areas of potential fraud, abuse, and waste when planning the fieldwork. For example, a DOE Inspector General investigative report on a program located in a different state highlighted the potential for fraud surrounding energy rebate applications and payments nationwide.

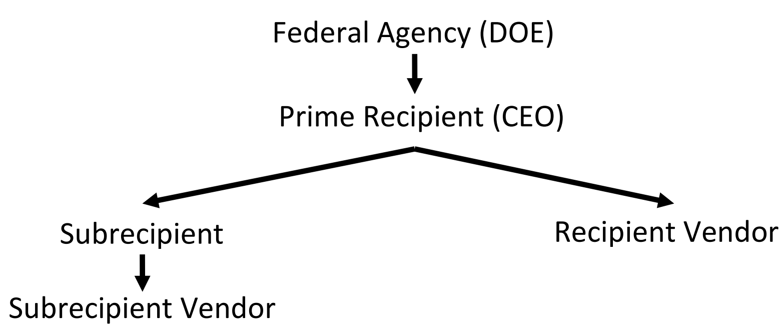
Finally, to ensure a full understanding of all requirements governing SEP, we reviewed applicable federal and state laws, regulations, and grant requirements.

Procedures Performed to Detect Fraud, Abuse, and Waste

According to the ACFE, 65 percent of frauds discovered in 2012 were uncovered by a tip, management review, or by accident. While the OSA's December 2012 *Colorado Energy Office Performance Audit* identified general weaknesses in internal controls, which increase the opportunities for fraud to occur, no specific predication of fraud was identified. Without a predetermined area to investigate, our fieldwork focused on casting a broad net designed to review as much of the SEP expenditures and activities as possible during the audit period and to focus on indicators of potential fraud, abuse, and waste.

Understanding the flow of cash was critical to performing an effective audit. CEO relies on multiple contractors to provide goods and services to achieve SEP goals and objectives. During State Fiscal Years 2008 through 2010, CEO paid amounts to a total of approximately 220 recipient vendors and subrecipients combined. Under the Program, funds were either spent directly by CEO through its recipient vendors or awarded and subsequently reimbursed to subrecipients, who contracted with their own subrecipient vendors. Funds spent by CEO on recipient vendors were done under a standard state contract or purchase order. Subrecipients received awards and were reimbursed by CEO according to grant agreements. Exhibit 1-2 portrays the flow of funds.

Exhibit 1-2
Flow of Funds for the State Energy Program



Source: Colorado Energy Office Grant Agreement Template.

To accomplish our objective, test work was done at both the CEO and subrecipient levels. Guided by our understanding of CEO from the risk assessment, our fieldwork included:

- Detection of high-risk transactions and vendors at the CEO level through:
    - Analysis of duplicate payments.
    - Determination of unusual payment transaction patterns.
    - Review of payments by project area.
    - Review of payments by subrecipients and vendors.
- Detailed review of high-risk transactions at the CEO level.
- Detailed review of high-risk transactions at the subrecipient level.
- Identification of potentially fictitious rebates.
- Identification of potentially fictitious contractors.
- Detection of procurement irregularities.
- Examination of nonperformance, including failure to deliver goods and services.

As part of our work, we interviewed CEO staff and, where necessary, contacted subrecipients and vendors. In all cases in which documentation was lacking, we followed up with CEO staff and subrecipients to ensure that goods and services were received in accordance with the terms and conditions of contracts and agreements.

Detection of High-Risk Transactions and Vendors

Duplicate Payments

Duplicate payment analysis is commonly used in fraud and forensic work to help determine whether a vendor, contractor, or individual has been paid more than once for the same goods or services. With the assistance of CEO staff, we were able to extract and analyze all SEP payments made during State Fiscal Years 2008 through 2010. This resulted in a database of more than 6,000 transactions totaling $14.6 million that included payroll, administrative expenditures, and payments to subrecipients and contractors. We employed data analytic techniques to identify duplicates and then investigated the potential for fraudulent, abusive, or wasteful activity.

Unusual Payment Transaction Patterns

We employed a methodology known as Benford's Law Analysis (also called First-Digit Law). Benford's Law is a proven methodology commonly used in fraud and forensic work to expose unusual patterns and transaction groupings by evaluating the expected distribution of leading digits in financial transactions. The assumption underlying Benford's Law Analysis is that transactions have an expected distribution, and fraudulent activity tends to deviate from this expectation. Benford's Law Analysis provides a mathematical method to identify these deviations and to allow the audit team to conduct further research. We conducted 1st, 2nd, and 3rd digit analyses using the database of 6,000 transactions described previously.

Review of Payments by Project Area

We summarized all SEP transactions by project area to better understand the use of the funds and to determine how to best test them. As can be seen in Exhibit 1-3, CEO spent over $14.6 million in funding during the period of audit, $10.7 million or 73 percent of which was associated with four project areas: rebates, public information, commercial buildings, and residential buildings. CEO established rebate programs to increase adoption of energy efficiency upgrades, reduce energy costs, and increase awareness of energy efficiency. The programs provided incentives to individuals and businesses. Funding for the Public Information campaign was earmarked for increasing public awareness of energy efficiency and renewable energy and available rebates. Funding for Commercial and Residential Buildings included incentives for improvements in energy efficiency. We focused most of our attention for identifying high-risk transactions and vendors in these top four project areas. Administrative Support had a similar level of expenditures as the Residential Buildings project area; however, Administrative Support primarily consisted of CEO payroll. Through our initial risk assessment, we determined that the risk of payroll fraud was low and did not include this as an area of focus for the audit.

Exhibit 1-3 State Energy Program Expenditures by Project Area Fiscal Years 2008 Through 2010		
Project Area	**Expended**	**% of Total**
Residential Rebates (Appliances)	$3,839,400	26.3%
Residential Rebates (Other)	$2,476,600	16.9%
Public Information	$1,686,100	11.5%
Commercial Buildings	$1,569,600	10.7%
Residential Buildings	$1,163,200	8.0%
Administrative Support	$1,156,200	7.9%
Capital Investment	$647,800	4.4%
Colorado Carbon Fund	$617,700	4.2%
Colorado Electric and Gas Utilities	$202,500	1.4%
Greening Government	$165,100	1.1%
Geothermal Support	$130,600	0.9%
Codes and Standards	$116,200	0.8%
Biofuels Dispersion	$112,800	0.8%
Residential Program Consultants	$103,900	0.7%
Re-Energizing Colorado	$99,100	0.7%
Efficiency Colorado Utility	$81,300	0.6%
Anaerobic Digestion	$73,400	0.5%
Transmission	$71,700	0.5%
Biomass	$62,100	0.4%
Energy Emergency Planning	$59,000	0.4%
Utility Issues	$57,700	0.4%
Community Small Wind	$44,200	0.3%
Assurance Plan	$43,300	0.3%
Residential Education and Outreach	$24,300	0.2%
Woody Biomass	$11,300	0.1%
TOTAL	**$ 14,615,100**	**100%**
Source: Two Hills Accounting & Consulting's summary of CEO data.		

Review of Transactions by Payee

We summarized all SEP transactions by payee to identify high-risk vendors and subrecipients. Specifically, we identified four groupings of payees that warranted further evaluation. We reviewed:

- All nine vendors that were paid more than $100,000 in total during the audit period. Vendors receiving large payments present several fraud risks, including preferential contractor selection schemes and overbilling.
- Five of the eight subrecipients that were paid more than $20,000 in funding from CEO. We were concerned about any irregularities associated with subrecipient procurement of vendors.
- Two vendors that were paid amounts close to the competitive procurement threshold for services of $25,000. A common fraud scheme is to circumvent contractor selection requirements by paying contractors a total amount just under a procurement threshold.
- Two CEO employees reimbursed for travel or other expenses. Employees interested in perpetrating fraud can misappropriate funds through reimbursements.

Detailed Review of High-Risk Transactions at the CEO Level

The procedures performed to detect high-risk transactions yielded a judgmental sample of 179 reimbursements/payments totaling $10.9 million, which provided coverage of approximately 75 percent of all expenditures during the audit period. For each transaction, we reviewed supporting documentation, including invoices and work statements, provided by subrecipients and vendors prior to payment. Specifically, we looked for the following indications of fraudulent activity:

- Dates, names, vendors, and/or addresses that did not match CEO accounting records.
- Requests for reimbursement that lacked adequate supporting documentation.
- Invoices lacking sufficient detail to trace the goods/services to program activities.
- Documentation that did not reconcile to amounts claimed.
- Lack of proper review and approval.

Detailed Review of High-Risk Transactions at the Subrecipient Level

To be reimbursed, subrecipients and vendors were not required to provide CEO with every invoice justifying costs incurred. Therefore, we extended our test work by requesting and reviewing all underlying documentation supporting payments to six subrecipients, including five of the eight subrecipients that received over $20,000. Where appropriate, we interviewed staff responsible for contracting with vendors and ensuring the integrity of the reimbursements. For example, if CEO reimbursed a local school district $200,000 for energy efficient building upgrades, we reviewed all invoices and supporting documentation from the district's vendors to determine the legitimacy of the request for reimbursement. We verified through third parties that the physical energy upgrades had actually been made.

Fictitious Rebates

For the period of audit, 43 percent of all SEP expenditures made were made under rebate programs. CEO contracted out administration of the rebate program to a vendor that was responsible for accepting and reviewing rebate applications and reimbursing applicants from a joint bank account held by CEO and the rebate vendor. Concerned about the potential for funneling money out of SEP through fictitious rebates, we obtained and reviewed an electronic file listing all rebates paid to individuals and contractors. This file contained the rebate amount and payee information (e.g., name and address) for approximately 39,000 rebates totaling $10.3 million paid throughout the course of the program. Due to timing issues, there was not a way to directly tie expenditures in the audit period to the rebates paid. As a result, we reviewed all rebates paid for the life of the program. Depending on the type of rebate (e.g., renewable energy, energy efficient appliances, energy efficiency upgrades), the amount of the rebate varied widely from $50 to $25,000.

CEO's rebate vendor was acquired by another company in 2013, and CEO no longer has access to the vendor's underlying systems; therefore, retrieval of information was challenging. However, we were able to obtain and review a database detailing all rebate payments made by the vendor. We used the database to conduct analytical procedures, including duplicate payment tests, high-dollar rebate review, and identification of payments to contractors and to CEO employees. The duplicate payment analysis was designed to identify any instances where an individual or entity potentially received multiple payments for the same rebate, either mistakenly (wasteful) or intentionally (fraudulently). The high-dollar rebates identified entities, typically contractors, that had received payments for multiple installations of improvements in numerous residential units. To identify any rebates fraudulently provided to CEO employees, we obtained a list of CEO employees and their addresses and cross-checked them against the rebates database. Based on the results of our analytical procedures, we further analyzed a sample of 82 rebates totaling over $85,000.

Fictitious or Unscrupulous Vendors

Funneling money through fictitious or unscrupulous vendors is a common fraud scheme. We checked each of the 71 vendors who received more than $10,000 in SEP funding during the audit period to verify that they were registered with the Colorado Secretary of State and appeared to be legitimate businesses.

Procurement Irregularities

For the audit period, SEP released payments to more than 220 contractors or subrecipients in support of its program goals. To evaluate the possibility that preferential treatment and/or procurement fraud or abuse could have occurred, we judgmentally selected a sample of 27 subrecipients/contractors to review the vendor selection process. We also reviewed the bidding documentation for the eight nongovernment recipient vendors that received more than $50,000 in SEP payments during the audit period. For each bid, we reviewed the total number of bidders, the timing of bid submissions, the sufficiency of bid documentation, the existence of signed conflict of interest statements, and the adequacy and accuracy of bid evaluation files.

Nonperformance

Failure to produce the goods and/or services required under grant terms and conditions is a key concern from the perspective of fraud, abuse, and waste. A subrecipient or vendor may have submitted, for example, bona fide invoices for reimbursement, but have failed to produce the agreed-upon deliverables. To identify any issues with deliverables, our in-depth review of 27 vendors included tests to ensure that there was sufficient documentation evidencing the completion of project activities and/or the purchase of goods and equipment. We evaluated progress reports and final reports submitted by subrecipients and vendors to CEO and sought other evidence confirming the completion of agreed-upon project activities. In those cases where documentation maintained by CEO was limited, we performed alternate procedures, including requesting documents from subrecipients and confirming deliverables.

Findings and Conclusions

Based on our extensive test work, we did not identify evidence that fraud, abuse, or waste occurred in SEP expenditures and activities during State Fiscal Years 2008 through 2010. However, because of the characteristics of fraud, particularly those fraud schemes involving concealment and falsified documentation, this does not mean we concluded that fraud, in particular, did not occur. Audits are designed to provide reasonable but not absolute assurance of detecting fraud that is significant within the context of the audit objectives. Thus, even a properly planned and performed audit may not detect fraudulent activity.

The results of our fraud risk assessment and extensive test work demonstrated that there was an environment conducive to a significantly increased risk of fraud, abuse, and waste in SEP expenditures and activities during the period under audit. Key factors contributing to an environment vulnerable to fraud, abuse, and waste include:

- **Internal Control Weaknesses.** As noted in the OSA's December 2012 *Colorado Energy Office Performance Audit*, insufficient controls existed to ensure that expenditures had adequate supervisory review and were supported with sufficient documentation to justify payment. Poor internal controls increase the opportunity for fraud to occur without it being detected. The AICPA's Practice Aid 07-1, *Fraud Investigations In Litigation Services* provides key indicators of an environment conducive to fraud, all of which we found were present at CEO during the period under audit:
    - Lack of written policies and standard operating procedures
    - Lack of compliance with internal control policies
    - Disorganized operations in areas such as bookkeeping and purchasing
    - Bank accounts not reconciled on a timely basis
- **Pressure to Spend Funds Quickly.** Congress urged federal, state, and local entities to spend Recovery Act funding quickly to stimulate the economy and spur job creation. Congress was interested in promoting "shovel ready" projects. While Colorado's SEP grant was awarded for a 36-month term, all funds were required to be committed within 18 months. In retrospect, CEO management acknowledged in its April 2012 Recovery Act Report that:

    > *"Pressure to get money out the door created many concerns as the office struggled to stay on plan, develop tracking and accounting tools, and provide accurate reports to the DOE."*
    >
    > *"DOE needed to staff-up to handle the increased volume and wisely added a technical assistance team to provide guidance to grant recipients. However, technical assistance did not come from the DOE until months into the program, after [C]EO had already developed most of its programs and tracking systems."*

    In our opinion, the pressure to push millions of dollars out the door quickly overwhelmed CEO's programmatic and financial infrastructure during the period under audit, increasing the risk of fraud, abuse, and waste. Internal controls at the time were insufficient to support adequate administration of the new funding that flowed in. Under the Recovery Act, Colorado was awarded 50 times the regular ongoing annual funding amount for SEP.

    While the substantial increase in SEP funding alone would have increased the risk of fraud, abuse, or waste, at the same time, funding for other CEO energy-related programs also increased dramatically. For example, in 2009, Colorado's Weatherization Program was allocated $79.5 million as compared to $5.5 million in the prior year, more than a 14-fold increase. The risks inherent in dramatic funding increases were well recognized. Congress appropriated the DOE Inspector General $15 million, for example, in additional funding for expanded audit and criminal investigation efforts.

- **Program Complexity.** SEP may have been more complex than necessary or reasonable. CEO awarded funding to a large number of small projects, increasing the demands on staff, and in our opinion, increasing the risk of fraud, abuse, or waste. CEO noted in its Final Recovery Act Report that the administrative burden of doing so many small projects became overwhelming and that larger projects and/or grants would have been easier to manage. Often the time spent on a $25,000 contract was the same as it would have been on a $250,000 contract.

  Further, in addition to the burdens imposed by the volume of small grants, CEO was challenged by new Recovery Act requirements along with already complex grant terms and conditions. In short, the difficulties of administering the program in accordance with laws and regulations and as designed by CEO was challenging.

- **Staffing Challenges.** The ramp-up and subsequent turnover in CEO staff contributed to training and management issues and likely increased the risk of fraud, abuse, or waste. In its Recovery Act Report, CEO management acknowledged significant staffing issues and noted that the 3-year term of the SEP Recovery Act grant proved to be a challenge in terms of staff turnover. Our audit work indicated a general lack of knowledge and experience in grants management during the audit period. Our interviews with current CEO staff noted the considerable effort required to correct prior errors and ensure proper accounting for expenditures.

Other Matters

During the course of performing our audit work, we noted certain other deficiencies in internal control and operational matters that were not significant to the objectives of our audit and that we reported to CEO management in a separate letter. These other deficiencies in internal control and operational matters are consistent with and corroborate the findings and recommendations included in the OSA's December 2012 *Colorado Energy Office Performance Audit*.