



**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, 2002**

Authority, Purpose, and Scope

This audit was conducted under the authority of Section 2-3-103, C.R.S., which authorizes the Office of 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 the financial and compliance standards contained in the *Government Auditing Standards* issued by the U.S. General Accounting Office. We performed our audit work during the period January 2002 through November 2002.

The purpose of this audit was to:

- Express an opinion on the State's Financial Statements for the fiscal year ended June 30, 2002.
- C Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2002.
- C Review internal accounting and administrative control procedures as required by generally accepted auditing standards.
- C Evaluate compliance with applicable state and federal laws, rules, and regulations.
- C Evaluate progress in implementing prior audit recommendations.

We expressed an unqualified opinion on the State's Financial Statements and an unqualified opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2002. Our opinion on the Financial Statements is presented in the State's Comprehensive Annual Financial Report, which is available in hard copy from the State Controller's Office and electronically at <http://www.sco.state.co.us/cafr/cafr.htm>. Our opinion on the Schedule of Expenditures of Federal Awards is presented under the Federal Awards Schedule section of this report.

For further information on this report, contact the Office of the State Auditor at (303) 869-2800.

General Fund Shortfalls

During Fiscal Year 2002 Colorado experienced significant decreases in revenue due to an overall economic decline similar to that experienced in many states. To deal with the budget gaps, states are considering a variety of measures including drawing down reserve balances, cutting programs, reducing Medicaid eligibility, changing personnel policies, delaying capital projects and, in some instances, raising taxes.

Colorado is limited by various legal constraints regarding the cost containment measures that are available. Like most states, Colorado is required to balance its budget annually. Article X, Section 16 of the Colorado Constitution prohibits the State from budgeting more expenditures than revenue earned for a fiscal year. Article XI, Section 3 of the Colorado Constitution prohibits the State from obligating its resources beyond one year, with the exception of capital construction.

In addition, the State must comply with limitations on revenue and spending established by Article X, Section 20 (TABOR) of the Colorado Constitution. TABOR limits the increase in the amount of revenue that the State can spend each fiscal year to the annual inflation rate plus the percentage change in the State's population. Revenue in excess of this limitation must be refunded to the taxpayers in the following year unless voters approve a revenue change that allows the State to keep the excess. House Bill 98-1414 authorized the State to defer, for budget purposes, the recognition of the TABOR liability from the year in which the refund is incurred to the following year. This resulted in the State's delaying budgeting for the \$927.2 million in TABOR refunds incurred in Fiscal Year 2001 until Fiscal Year 2002. This deferral contributed to the budgetary shortfall experienced in Fiscal Year 2002 because of the decline in state revenue in that year. Additionally, TABOR requires the State to reserve 3 percent of revenue for emergencies. Due to lack of adequate cash, the State's required \$217.5 million reserve includes \$96.8 million of capital assets in the Wildlife Cash Fund (44 percent of the reserve).

The State began Fiscal Year 2002 with an unreserved fund balance in the General Fund of \$255.6 million, and at that time, general fund revenue was projected at \$6.542 billion for the year. However, actual Fiscal Year 2002 revenue was only \$5.575 billion, or about 15 percent lower than anticipated. In order to meet constitutional requirements prohibiting a deficit fund balance in the General Fund at year-end, the Governor initiated cost containment measures including halting many capital construction projects, implementing a temporary hiring freeze, and requiring a 1.5 percent overall cut in expenditures. Additionally, the General Assembly authorized the transfer of about \$790 million in fund balances from various cash funds to the General Fund (see Appendix C for a listing of the transfers). Further, the General Assembly reduced the statutory reserve required under Section 24-75-201.1(1)(d)(VI), C.R.S., from 4 percent of general fund expenditures to zero, which provided an additional \$213.7 million. At June 30, 2002, the unreserved fund balance in the General Fund was \$137.6 million.

The reduction of the 4 percent reserve requirement and the transfers from cash funds to the General Fund are short-term solutions to balancing the State's budget. If revenue continues to decline in Fiscal Year 2003 as projected, actual cuts in programs and personal services will be required. (For further information on the State's financial condition, see the "Management's Discussion and Analysis" prepared by the State Controller in the State's Comprehensive Annual Financial Report.)

The State also faces the long-term impact of the \$790 million in transfers from the various cash funds to the General Fund. The General Assembly passed 11 bills authorizing these transfers, and Section 24-75-201.5, C.R.S., allows for transfers to avoid deficits in the General Fund. The State Controller appropriately disclosed the transfers in the State's Fiscal Year 2002 Financial Statements (see Note 31 in the Comprehensive Annual Financial Report). The transfers mean that these funds will not be used for the specific purposes originally intended under state law. For example, the transfers included the elimination of \$253.4 million set aside for financing the ongoing maintenance of state buildings, reductions of \$141.6 million for financing programs funded by monies from the Tobacco Litigation Settlement Agreement, and reductions of \$211.5 million in funding designated for major medical claims under the State's Workers' Compensation program. The reduction or elimination of these and other set-asides will result in greater demands on the General Fund in the future, as well as reductions in programs and possible increases in fees.

Current Year Findings and Recommendations

This report presents the results of the Statewide Financial and Compliance Audit for Fiscal Year 2002. The report may not include all findings and recommendations from separately issued reports on audits of state departments, institutions, and agencies. However, in accordance with the Single Audit Act, this report includes all findings and questioned costs related to federal awards that came to our attention through either the Statewide Financial and Compliance Audit or other audits.

As part of our Statewide Financial and Compliance Audit, we examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements. We considered the internal controls over financial reporting; tested compliance with certain provisions of federal and state laws, regulations, contracts, and grants; and tested account balances and transactions for proper financial reporting. The following presents highlights of findings included in our report. Please refer to the Recommendation Locator following this summary for a complete listing of all recommendations, agency responses, and implementation dates, as well as references to the location of each recommendation in the report.

Internal Controls

Agencies are responsible for having adequate controls in place to ensure compliance with laws and regulations and with management's objectives. As part of our audit, we tested controls over the processing

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of transactions and accounting for financial activity and identified the need for improvements in the following areas.

- The Department of Revenue lacks controls over income tax credits to ensure claims for credits are valid. We examined 205 income tax returns to test controls over the 15 TABOR refund mechanisms in place in Fiscal Year 2002 and determined that 54 returns (26 percent) were erroneously granted tax credits totaling \$248,902. In addition, we reviewed the Department's controls over the charitable contributions deduction and determined that the State may have received about \$198,000 less in revenue because the Department lacks necessary reviews to determine if the deductions are valid.
- The Department of Revenue's controls over manual adjustments made to tax returns are inadequate. We identified an instance in which an improper adjustment to a return erroneously resulted in a \$327,000 reduction in the TABOR liability. We found that the Department does not have sufficient controls over system-generated letters to taxpayers when manual adjustments were made.
- Our prior audit found that some taxpayers do not receive their personal property tax refunds. In our Fiscal Year 2002 audit, we noted similar problems. We identified 2,400 outstanding personal property tax refund checks totaling \$2.1 million, many issued more than a year before.
- We reviewed the Department of Personnel and Administration's \$27 million annual payroll and found a lack of segregation of payroll duties and inadequate compensating controls, inconsistencies between the State's payroll database and related employee withholding documents, and errors in biweekly payroll calculations.
- The Department of Human Services did not have adequate controls over year-end exhibits submitted to the State Controller's Office for preparation of required financial disclosures. We found errors related to reporting of risk financing, changes in long-term liabilities, capital lease reporting, estimates for accounts payable, and federal grant expenditures.
- The Department of Natural Resources needs to strengthen controls over procurement cards. We found problems with 21 of the 25 employee cardholder statements tested. Problems included lack of review of monthly statements by supervisors, the absence of agreements signed by supervisors indicating an acknowledgment of their responsibilities to monitor card usage, and a lack of agreements from employees documenting their acceptance of responsibility for appropriate usage of the card.

- We found that four departments (Departments of Labor and Employment, Natural Resources, Personnel and Administration, and Regulatory Agencies) did not properly record certain revenue and accounts receivable at fiscal year-end and that the four need to improve procedures for year-end adjustments.

Financial Reporting

Agencies are responsible for accurately reporting financial activity. In addition, the State Controller's Office (SCO) minimizes the risk of inaccurate reporting by establishing standard policies and procedures. As part of our audit, we reviewed the policies and procedures related to financial reporting that were in place at both the SCO and agencies, and tested a sample of financial transactions to ensure that financial activity was reported properly.

During Fiscal Year 2002 the State Controller's Office implemented Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*, which establishes new financial reporting requirements for governments. These requirements significantly restructured the information presented in the State's Financial Statements and resulted in new information being presented. We found two areas for improvement related to the implementation of Statement No. 34.

- Inconsistencies exist in how some transactions were categorized between the State's and the higher education institutions' statements of cash flows. For example, the higher education institutions reported gifts of approximately \$72.8 million in the cash flows from noncapital financing activities section, while on the State's financial statements only \$1.3 million of gifts are reported this way. We also identified a difference of \$32 million between the statement of cash flows for the State and the Student Obligation Bond Authority (CSOBA) because the definition of cash used by CSOBA was different than that prescribed by the State.
- New requirements for capitalization and depreciation of certain long-lived assets resulted in errors in estimated useful lives for buildings and/or leasehold improvements, as well as the need for establishment of capitalization thresholds. We also noted that the Department of Transportation did not record accumulated depreciation of \$18 million in prior years, and \$700,000 in the current year, until our audit brought the need for the entries to the Department's attention.

Federal Grants

The State received about \$4.6 billion in federal grants in Fiscal Year 2002. As part of our audit, we determined compliance with federal regulations and grant requirements. The audit work included, among

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other requirements, testing of allowable activities, allowable costs, cash management, eligibility, reporting, and subrecipient monitoring.

Medicaid: The Medicaid program, administered by the Department of Health Care Policy and Financing (HCPF), is the State's largest federal program. During Fiscal Year 2002, Medicaid expenditures exceeded \$2.3 billion (state and federal funds). Some of the more significant problems noted with the management of the Medicaid program were as follows:

- Adequate controls are not in place to ensure all Medicaid providers are properly licensed and have signed required agreements with the State. We tested a sample of 30 Medicaid provider files and found that only 6 had appropriate documentation on file.
- Erroneous payments were made. For the Residential Treatment Centers (RTC) program, we tested nearly 1,500 claims filed during one month to determine whether the claims submitted by providers were accurate. We found at least one error in 455 (30 percent) of the claims tested; further, these errors were not detected by the Medicaid Management Information System, which processes Medicaid claims. These errors totaled over \$98,000 for the month tested.
- Program overlaps resulted in excess payments. State law prohibits Medicaid-eligible individuals from being served in the Colorado Indigent Care Program (CICP). We tested a three-month period and identified 1,600 individuals enrolled in Medicaid who received services under CICP in the same period. We estimated that providers were reimbursed about \$554,800 under CICP for these services which should have been covered under Medicaid. Additionally, since most Medicaid recipients are under managed care, the State likely paid monthly capitation payments to providers under the Medicaid program on behalf of many of these 1,600 individuals.

Cash Management: The Cash Management Improvement Act (CMIA) was established to regulate the transfer of federal funds between federal and state agencies for certain large federal programs. The Office of the State Treasurer is responsible for the coordination of CMIA for Colorado. In Fiscal Year 2002, 30 federal programs were covered by CMIA at seven different state agencies. These programs had federal expenditures of about \$1.4 billion. We found problems related to cash management at three departments. For example, we found that the Department of Human Services requested federal funds one to five days later than required for 22 of the 34 electronically issued payments tested (65 percent) and one day earlier than allowed for 35 of the 53 warrants tested (66 percent).

Student Financial Aid: State higher education institutions paid out about \$349 million in student loans and grants in Fiscal Year 2002. We found the following problems at various state schools.

- At seven institutions, including six community colleges, controls were not adequate to prevent overpayments to students receiving financial aid and to ensure the return of federal funds in cases where students withdrew from school. Two institutions' files did not contain evidence of the required counseling session for students that were leaving school.
- At two institutions, documentation in student files was not sufficient to support decisions such as student loan deferments or cancellations or for determining the amount of families' required contributions, which affects the amount of student aid provided.
- At one institution, controls were lacking over vocational education grant monies to ensure that disbursements were not made in advance of expenditures by subrecipients. In addition, controls were not sufficient to ensure funds were spent in accordance with federal requirements.

Foster Care, Temporary Assistance for Needy Families (TANF), Low-Income Energy Assistance Program (LEAP), and Subsidized Adoption: We found problems at the Department of Human Services with the administration of other federal programs. These four programs represent over \$227 million, or 33 percent, of the \$699 million in federal funds expended by the Department in Fiscal Year 2002. We noted the following areas where improvements were needed.

- Fiscal and programmatic controls over the Foster Care program are inadequate. For example, we found a lack of documentation to support \$29,000 in charges for Medicaid-reimbursed case management services claimed by child placement agencies (CPAs), and we identified questionable expenditures totaling more than \$1.1 million (all funding sources) across 6 of the 10 CPAs reviewed (65 percent). Expenditures included payments to family members and payments for personal items. We also determined that the Department did not conduct federally required quality assurance reviews for the 9,400 children receiving "in-home" services or placed in foster care for fewer than six months during Fiscal Year 2002.
- We sampled 79 Subsidized Adoption case files and found that in 24 cases (30 percent), providers paid children past the legal age when the subsidy should end. The State could be liable to the federal government for about \$233,000 of these funds.
- We found that the Colorado Trails system, designed to meet new federal reporting requirements for children in Subsidized Adoption and Foster Care, contained duplicate client and provider records causing reports to be inaccurate. Duplicate records and problems with the system's interface with the County Financial Management System contributed to inaccurate provider payments. A balance of \$650,000 in potential overpayments was unresolved at the time of our audit.

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- Our audit of the TANF Diversion Program indicated problems in 77 of the 239 cases in our sample. In total, we identified \$94,000 in questioned costs. We also noted that the Department did not perform the federally required match of applicants' financial information against other databases, such as the State's wage database from the Department of Labor and Employment, to ensure applicants met income limitations.
- Our review of 400 LEAP files indicated that the Department needs to ensure that counties sufficiently document information used to determine eligibility, calculate benefit amounts, and determine adherence to timeliness standards.

Communication of Audit-Related Matters

There were no significant or unusual matters reported in connection with the audit of the State of Colorado for the year ended June 30, 2002. Areas in which uncorrected misstatements were aggregated during the Fiscal Year 2002 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 fund balances by about \$2.3 million, decrease assets by about \$8.6 million, increase liabilities by almost \$3 million, increase revenue by about \$4.8 million, and increase expenditures by about \$3.1 million. See Appendix B, which shows the net and gross passed audit adjustments by agency and the net and gross posted audit adjustments by agency.

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 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 the Single Audit Act, the CFDA No./Compliance Requirement/Federal Entity column is marked "not applicable."

Summary of Progress in Implementing Prior Year Recommendations

This report includes an assessment of the disposition of prior audit recommendations reported in both the Statewide Single Audit Reports and the Statewide Financial and Compliance Audit Reports for Fiscal Years 1997 through 2001. If a recommendation was reported in both reports, it has only been included once in the following table. Additionally, prior years' recommendations that were implemented in Fiscal Year 2001 are not included.

Statewide Single and Financial Audit Reports by Fiscal Year¹					
	Total	2001	2000	1999	1997
Implemented	70	54	13	3	0
Partially Implemented	24	18	1	4	1
Not Implemented	9	9	0	0	0
Deferred	11	8	3	0	0
Ongoing	2	2	0	0	0
No Longer Applicable	1	0	1	0	0
Total	117	91	18	7	1

¹ All recommendations from the Fiscal Year 1998 audits have been implemented, carried forward to a subsequent year, or are no longer applicable.