



**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, 2005**

**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 with *Government Auditing Standards* issued by the Comptroller General of the United States. We performed our audit work during the period March through December 2005.

The purpose of this audit was to:

- Express an opinion on the State's financial statements for the fiscal year ended June 30, 2005.
- Express an opinion on the State's Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2005.
- Review internal accounting and administrative control procedures as required by generally accepted auditing standards and generally accepted government auditing standards.
- Evaluate compliance with applicable state and federal laws, rules, and regulations.
- Evaluate progress in implementing prior audit recommendations.

We expressed an unqualified opinion on the State's financial statements for the fiscal year ended June 30, 2005. Our opinion on the financial statements is presented in the State's Comprehensive Annual Financial Report for Fiscal Year 2005, which is available in hard copy from the State Controller's Office and electronically at [www.colorado.gov/dpa/dfp/sco/cafr/cafr05/cafr05.htm](http://www.colorado.gov/dpa/dfp/sco/cafr/cafr05/cafr05.htm).

We issued a report on the State's compliance with internal controls over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*. We noted matters involving the internal controls over financial reporting and its operation that we consider to be reportable conditions and material weaknesses.

*For further information on this report, contact the Office of the State Auditor at 303.869.2800.*

## SUMMARY

- As defined by *Government Auditing Standards*, reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls over financial reporting that, in our judgment, could adversely affect the State of Colorado's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 1-38, 67-70, 72-74, and 77-88.
- As defined by *Government Auditing Standards*, a material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Material weaknesses are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 10, 38, 69-70, 72-74, 77-87.

We also issued a report on the State's compliance with requirements applicable to each major program and internal controls over compliance in accordance with OMB *Circular A-133*. 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.

- We determined the State did not comply with requirements regarding Eligibility and Reporting that are applicable to its Medicaid (CFDA Nos. 93.777 and 93.778) and Food Stamps (CFDA Nos. 10.551 and 10.561) Clusters and the Temporary Assistance for Needy Families (CFDA No. 93.558) program. Compliance with such requirements is necessary, in our opinion, to comply with 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. 38, 69-70, 72-74, and 77-87.
- We noted certain matters involving the internal controls over compliance and its operation, in accordance with OMB *Circular A-133*, that we consider to be reportable conditions and material weaknesses. Reportable conditions and material weaknesses are described in the accompanying schedule of findings and questioned costs as Recommendation Nos. 38-51, 53-65, 69-74, 77-96 and Recommendation Nos. 38, 69-70, 72-74, and 77-87, respectively.

## Current Year Findings and Recommendations

This report presents the results of the Statewide Single Audit for Fiscal Year 2005. 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 Single Audit or other audits.

As part of our Statewide Single 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. The Recommendation Locator following this summary 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

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:

- Four agencies lacked sound controls over access to information systems. At the Colorado Historical Society and the Department of Public Safety, we identified employees who had the ability to not only enter but also to correct and approve transactions on the State's accounting system, COFRS. Inadequate segregation of duties increases the risk of errors and irregularities. At the Department of Revenue and the Department of Transportation, controls were not adequate to ensure sensitive information was safeguarded from potential unauthorized access.
- The Department of Revenue did not have adequate controls in place over taxpayer returns. We found manual adjustments made to high-dollar tax returns that were not posted correctly to the Department's income tax accounting system or adequately reviewed to determine if the taxable incomes were calculated properly. Further, we found that the Department does not have controls in place to ensure that only qualifying credits are claimed on tax returns. Finally, the Department does not consistently review edits made to taxpayer information.

- The Department of Human Services continues to have problems with overall accounting controls to safeguard capital assets, properly report revenue, and ensure payroll transactions were appropriate.

## **Financial Reporting**

State agencies are responsible for reporting financial activity accurately and completely. The State Controller's Office (SCO) establishes standard policies and procedures that must be followed by state agencies and institutions. As part of our audit, we reviewed the policies and procedures related to financial reporting that were in place at the SCO, agencies, and institutions and tested a sample of financial transactions to ensure that controls were adequate and financial activity was reported properly. We found:

- The overall internal controls over financial reporting at the Department of Health Care Policy and Financing were lacking. Accounts receivable of \$3.4 million had not been fully reconciled to the subsidiary ledger and an estimate for uncollectible accounts of \$6.9 million related to the Department's drug rebate program was not substantiated by historical analysis. The Department did not have adequate oversight of the year-end accrual of \$167.5 million in claims liabilities that had been incurred but not yet reported. Schedules and year-end exhibits prepared and submitted by the Department contained errors and required revisions.
- Four departments (Health Care Policy and Financing, Human Services, Natural Resources, and Transportation) did not perform adequate reconciliations between their internal systems and the State's accounting system, COFRS, to ensure that the amounts reported on the State's financial statements are correct. We found that better controls over reconciliations are needed at all four departments.
- Two departments recorded year-end balances that were either incorrect or could not be substantiated with detailed supporting documentation. The Department of Natural Resources overstated two accounts on COFRS by a total of \$9.4 million. The Department of Labor and Employment was unable to provide supporting documentation for unemployment tax refunds of approximately \$9.1 million or for unemployment benefits payable of \$8.2 million.
- The Department of Revenue understated long-term individual and corporate income tax receivables and payables by \$16.7 and \$51.1 million, respectively, as a result of a lack of timely review by experienced staff. All adjustments identified as a result of the problems were reflected in the State's Fiscal Year 2005 financial statements.

## Federal Grants

The State expended about \$5.4 billion in federal grants in Fiscal Year 2005. As part of our audit, we determined compliance with federal regulations and grant requirements. Among other requirements, we tested for allowable activities, allowable costs, cash management, eligibility, reporting, and subrecipient monitoring.

**Colorado Benefits Management System (CBMS):** In September 2004, the Department of Health Care Policy and Financing (HCPF) and the Department of Human Services (DHS) implemented a new automated system known as CBMS. CBMS was intended to provide one unified system for data collection and eligibility determination for 92 HCPF and DHS programs within 12 high-level program groups, including Medicaid, Food Stamps, and Temporary Assistance for Needy Families (TANF). We reviewed the Departments' procedures for complying with federal requirements for determining the eligibility of the individuals who receive Medicaid, Food Stamps, and TANF benefits and the providers who receive reimbursements under the Medicaid program. We found the following:

- For Food Stamps we selected a statistically valid sample of 96 payments. We found that 69 of the 96 payments in our sample (72 percent of payments sampled) contained at least one error; for the 69 payments containing errors we identified questioned costs of \$4,500 out of the total sampled costs of \$22,507 (20 percent of costs). The error rates for both numbers and dollars for the Food Stamp program are clearly unacceptable. With total Food Stamp benefit payments for the 10-month period tested of \$256 million and average number of recipient households per month at 95,000, the risk to the State is significant.
- For TANF, we selected a statistically valid sample of 96 payments. We found that 24 of the 96 payments in our sample (25 percent) contained at least one error; for the 24 payments containing at least one error, we identified questioned costs of \$4,783 out of the total sampled costs of \$24,027 (20 percent of costs). The error rates for both numbers and dollars for the TANF program are unacceptable. With total TANF benefit payments for the 10-month period tested of \$49 million and average number of recipient households per month at over 15,000, the risk to the State is significant.
- For Medicaid, we were concerned about the large dollar range of claims paid and selected a stratified sample of 96 payments. The items selected included 36 claims under \$1,000; and 30 claims each from the categories of between \$1,000 and \$10,000 and over \$10,000. We found that 39 of the 96 payments in our sample (41 percent) contained at least one error; for the 39 payments we identified questioned costs of \$156,984 out of the total sampled costs of \$538,381 (29 percent of costs). The error rates for both number and dollar cost for the Medicaid program are unacceptable. With total Medicaid claims paid for the 10-month period tested of over \$1.6 billion, the risk to the State is significant.

## SUMMARY

- CBMS was not programmed to automatically provide an accessible case history for each benefit recipient. Case history is important to track the changes made to a recipient's file. Without the capability to easily review historical changes, the risk of fraud and errors increases.
- We were unable to obtain a listing of applicants determined to be ineligible. Therefore, we were unable to conclude on whether these determinations were appropriate. This is a serious problem because the State has an obligation to provide benefits to all eligible applicants.
- CBMS does not provide reports required to adequately oversee and monitor the TANF and Food Stamps programs. For TANF, pre-defined reports were unavailable to ensure that income was verified, sanctions were properly applied, and overpayments were pursued when appropriate. For Food Stamps, there was not a detailed report available on tax intercept data to ensure amounts reported on the Status of Claims Against Households (FNS-209) report are accurate and applied against benefits.

**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 2005, Medicaid expenditures for administration and claims paid at HCPF totaled about \$2.8 billion (state and federal funds). Significant problems noted with the management of the Medicaid and Children's Basic Health Plan programs include:

- The Department excluded over \$9.1 million in expenditures for the Children's Basic Health Plan Grant from the Quarterly Federal Cash Transactions Report. The report was not reviewed prior to submission.
- Outpatient hospital cost reports have not been generated by the Department in a timely manner. This has created a backlog in the performance of outpatient hospital cost report audits. The backlog increased from 50 reports in Fiscal Year 2004 to 108 reports in Fiscal Year 2005. As a result, the Department does not know if funds are due to the State from providers or if the Department owes funds to the providers.

**Homeland Security:** The Department of Local Affairs expended nearly \$44.5 million in federal funds for the administration of the Homeland Security Grant Program in Fiscal Year 2005. We noted the following concerns with the overall management of the program:

- About \$2 million in federal funds was expended for questioned costs related to reimbursements to subrecipients for direct purchases of equipment, activities, and services.
- Six of 20 subrecipients tested used grant funds to purchase equipment that was not ready for deployment, violating federal requirements. Subrecipients were not provided guidance

regarding equipment readiness or responsibility for the storage, repair, and maintenance of grant-purchased equipment.

- The Department used \$5.9 million in grant funds, \$3.2 million of which was from the Homeland Security Grant Program, for state procurement purposes rather than for local government needs. This was done in violation of homeland security grant requirements.

**Student Financial Aid:** State higher education institutions paid out about \$483 million in student loans and grants in Fiscal Year 2005. We found the following problems at various state institutions:

- At three institutions, controls over the reporting of federal financial assistance through the Fiscal Operations Report and Application to Participate (FISAP) report were inadequate to ensure that amounts reported were accurate and adequate supporting documentation was maintained.
- At six institutions adequate controls were not in place to prevent overpayments to students receiving financial aid and to ensure the return of federal funds in cases where students withdrew from school. We noted cases in which the institutions miscalculated the number of days in the semester and in which professional adjustments to the cost of attendance were not adequately documented.
- At two institutions, controls over draws of federal funds were not adequate to ensure draws are appropriately monitored, proper segregation of duties exist, or that draws were sufficient to cover federally-reimbursable expenditures. Further, we found at one institution advances of funds were performed earlier than allowed by federal regulations.

### **Communication of Audit-Related Matters**

There were no unusual or significant matters reported in connection with the audit of the State of Colorado for the year ended June 30, 2005. Uncorrected misstatements identified during the Fiscal Year 2005 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 about \$560,000, decrease assets by about \$2.3 million, increase liabilities by over \$2.0 million, increase revenue by about \$660,000, and increase expenditures by nearly \$4.5 million. Appendix B shows the net and gross passed audit adjustments by agency and the net and gross posted audit adjustments by agency. A full disclosure of communications required under generally accepted auditing standards can be found in the Required Communications section.

## SUMMARY

### 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 Recommendations

This report includes an assessment of the disposition of prior audit recommendations reported in the Statewide Single Audit Reports. Prior years' recommendations that were implemented in Fiscal Year 2004 or earlier are not included.

<b>Statewide Single Audit Reports by Fiscal Year</b>					
	<b>Total</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Implemented	61	42	11	4	4
Partially Implemented	33	18	7	5	3
Not Implemented	13	9	3	1	-
Deferred	19	18	-	1	-
Ongoing	6	5	1	-	-
In Progress	1	1	-	-	-
No Longer Applicable	1	-	-	-	1
<b>Total</b>	<b>134</b>	<b>93</b>	<b>22</b>	<b>11</b>	<b>8</b>