



**REPORT OF**

**THE**

**STATE AUDITOR**

**Colorado State Historical Fund**

**Performance Audit  
of the Use of Historical Grant Funds  
October 2004**

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October 27, 2004

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the grant funds administered by the Colorado State Historical Fund. 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 the state government. The report presents our findings, conclusions, and recommendations, and the responses of the Colorado Historical Society.

A handwritten signature in cursive script that reads "Joanne Hill".

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JOANNE HILL, CPA  
State Auditor

**Colorado State Historical Fund  
Performance Audit  
Use of Grant Funds, October 2004**

**Authority, Purpose, and Scope**

This performance audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct performance audits of all departments, institutions, and agencies of the state government. The audit work, performed between July and October 2004, was conducted in accordance with generally accepted government auditing standards.

The purpose of this performance audit was to evaluate the Colorado Historical Society's (the Society) management and oversight of grant monies administered through the State Historical Fund (the Fund) and provided to local grant recipients. As part of the audit, we evaluated the Society's administration of the Fund, examined a sample of grant files maintained by the Society and by grant recipients, and evaluated the Society's grant contracting and oversight processes.

**Overview**

According to the Colorado Constitution, 28 percent of the State's annual distributions derived from limited stakes gaming taxes in Colorado are to be deposited into the State Historical Fund for historic preservation and restoration throughout the State. Each year, as required under the Constitution, 20 percent of the Fund is distributed to the three gaming cities for their preservation and restoration, while the remaining 80 percent is administered by the Colorado Historical Society for historic preservation and restoration of historical sites and municipalities. Our audit reviewed the Society's management of grant funds administered from this 80 percent. Between Fiscal Years 1999 and 2004, net revenues available to the State Historical Fund (revenues less the automatic 20 percent distributed to the gaming cities) increased 34.5 percent, from \$16.5 million to \$22.2 million.

According to statutes, the Colorado Historical Society is to make grants for historic preservation purposes. The Society has established several types of grants: 1) General Competitive Grants for projects such as acquiring and developing historic sites and providing education; 2) Noncompetitive Grants which are generally limited to \$10,000 each and are available for projects such as preparing reports on the physical condition of historic buildings and evaluating archaeological information to create plans for preservation work; and 3) Internal Grants for historic preservation projects undertaken by the Society. Since the first year grants were made available (1993) the Colorado Historical Society has awarded over 2,780 grants from the Fund totaling about \$153.6 million, averaging about \$55,100 per grant and \$12.8 million per year.

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

## **Summary of Audit Comments**

### **Management of the State Historical Fund**

The amount of funds awarded as external grants from the State Historical Fund has increased from about \$9.1 million in Fiscal Year 2000 to about \$11.9 million in Fiscal Year 2004 (excluding the Capitol Life-Safety Project grant which funds renovations of the State Capitol). However, over the same period, the proportion of total expenditures from the Fund for external grants has decreased from 82 to 52 percent (excluding the required annual distribution to the gaming cities and the Capitol Life-Safety Project grant). The primary reason for the decrease is the use of Fund monies for the Capitol Life-Safety Project which received \$5.3 million in Fiscal Year 2004. Another factor that affects the amount of external grants available to general applicants is the appropriation of a portion of the Fund each year to pay part of the Society's operating costs beginning in Fiscal Year 2003. This appropriation replaces General Fund monies. For Fiscal Year 2004, the Society spent about \$3.6 million of monies appropriated from the Fund for Society operations.

Because the funds available for historic preservation projects are limited, the Society should manage the Fund as efficiently as possible. We noted a number of areas in which the Society could help ensure that monies available for external grants are maximized.

- The Fund's administrative expenditures have increased by about a third over the past five years, from about \$885,000 in Fiscal Year 2000 to about \$1.2 million in Fiscal Year 2004. The Society reports its administrative costs for managing the grant program in its annual report but does not show the trend of these costs over several years. Year-to-year comparisons of administrative costs help ensure that increases in these expenditures are disclosed and analyzed.
- The Fund provides monies for internal grants for projects carried out by the Society which do not compete with other general grant requests. Some of these grants pay for operating activities of the Society, such as rehabilitating historic properties operated by the Society. The Society should consider whether to include all internal grants in its operating appropriation or provide for some external, independent review of internal grant applications, such as through the competitive grant process.
- The Society does not have adequate processes to ensure that available monies in the Fund are distributed as quickly as possible through the grant-making process. The Society has not established a minimum year-end uncommitted fund balance that should be maintained in the Fund and does not have adequate budgetary processes to identify uncommitted funds available for grants. Accurately tracking uncommitted funds is important because the demand for grant monies exceeds the supply. On average, the Society has awarded about 70.5 percent of the grant amounts requested each year between Fiscal Years 1999 and 2004.

- There are delays in how quickly funds are expended once they are committed to specific grants. First, there can be delays between the time a grant is awarded and when it is placed under contract and work on the project begins. The Historical Society Board can rescind a project that is not making adequate progress but the Society has no formal requirements for when the Board should review grant awards for possible rescission. Second, the Society typically encumbers grants in the year they are awarded, although many projects take several years to complete. Clarifying grant guidelines to encourage segmentation of projects into annual phases would improve cash flow and more closely match revenues and expenditures.

### Grant Oversight

Grant recipients are required to submit periodic financial reports to the State Historical Fund to document grant project expenses. In addition, grant program staff conduct desk audits of the grants using documentation maintained and submitted by the grantees. We noted the following areas in which the Society's oversight of grants could be improved.

- The Society's guidelines are unclear with respect to whether administrative or indirect costs can be charged to either grant funds or cash match and do not provide any specific guidance on calculating or documenting administrative charges. We reviewed one project in which the grantee charged an excessive rate for supervision of the grant project and could not provide supporting calculations for the administrative charges.
- Some grant recipients do not advertise or competitively bid their projects. For 7 of the 15 grants we reviewed (47 percent), the grantees did not competitively bid work on the project. Bidding helps ensure that limited state funds are spent cost-effectively and prevent conflicts of interest in the selection of contractors.
- In some cases, the Fund's guidelines are unclear and do not appear to be consistently applied. For one grant we reviewed, the Society approved grant funding for interior rehabilitation of residential space although the guidelines state that, for private residential properties, "grant funds should be restricted to exterior work." For another project, the Society accepted an in-kind donation as a cash match although the guidelines state that "in-kind contributions cannot be applied to the cash match requirement." According to Society staff, in some instances, internal project work can be funded by a grant and in-kind matches are allowed.

Our recommendations and the Society's responses can be found in the Recommendation Locator of this report.

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**RECOMMENDATION LOCATOR**  
**Agency Addressed: Colorado Historical Society**

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Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
1	17	Ensure that funds available for external grants are maximized either by formalizing criteria for internal grants and instituting a process for some type of independent, external review of internal grant applications or by including internal grants in the annual appropriation for the Society's operations. Include, in the annual report, trend information for at least three years on the costs of administering the Fund.	Agree	April 2005
2	19	Improve policies for funding grants that generate a profit for the grantee by requiring grantees to certify that any profits from a grant-funded project will be used to further their historic preservation missions.	Agree	January 2005
3	23	Improve management of resources available to the State Historical Fund by establishing a reserve amount to be maintained for the uncommitted fund balance and improving the budgeting process.	Agree	January 2005
4	27	Improve cash management by formalizing and enforcing criteria to identify projects that could be funded in phases and establishing policies for the Board to periodically review grant awards for possible rescission.	Agree	January 2005
5	30	Amend the grant guidelines to clarify how administrative costs charged to grant projects should be calculated and documented.	Disagree	--
6	32	Clarify the grant guidelines to require that grantees obtain detailed invoices from their contractors and maintain such invoices in their grant files.	Agree	January 2005

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**RECOMMENDATION LOCATOR**  
**Agency Addressed: Colorado Historical Society**

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<b>Rec. No.</b>	<b>Page No.</b>	<b>Recommendation Summary</b>	<b>Agency Response</b>	<b>Implementation Date</b>
7	33	Require grantees to use a competitive bidding process for project work or certify that another fair and open selection process was used.	Agree	January 2005
8	35	Clarify and enforce grant guidelines by specifying circumstances in which grant funding of interior work is allowed, in-kind donations will be accepted as cash match, and how cash match and grant funds should be reported.	Agree	January 2005

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# Overview of the State Historical Fund

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## Description of the State Historical Fund

In 1990, Colorado voters passed a constitutional amendment approving limited stakes gaming in Central City, Cripple Creek, and Black Hawk. According to Article XVIII, Section 9, of the Colorado Constitution, 28 percent of the State’s annual distributions derived from limited stakes gaming taxes is to be devoted to historic preservation and restoration throughout Colorado. The Constitution provides that these historic preservation funds are to be deposited into the State Historical Fund (the Fund) within the Colorado Historical Society (the Society). The Constitution also requires that 20 percent of the annual amount deposited to the Fund be distributed to the three gaming cities specifically for their preservation and restoration. The Society has no authority over this 20 percent but does administer the remaining 80 percent in accordance with statute “for the historic preservation and restoration of historical sites and municipalities throughout the state.” In addition to administering the Fund, the Society operates a number of historic sites, museums, and a reference and research library, and provides historic and archaeological preservation services. Our audit reviewed the Society’s management of grant funds administered from the 80 percent portion of the Fund; we did not review the use of the 20 percent portion of the Fund that is distributed directly to the gaming cities.

According to Section 12-47.1-1201(1), C.R.S., the Society is to make grants for the following historic preservation purposes:

- **Survey**—identifying, evaluating, and designating buildings and places important in the history, architecture, archaeology, or culture of the State.
- **Development**—stabilizing, preserving, and restoring such places.
- **Education**—providing education and training on historical preservation for governmental entities, citizens, and organizations.
- **Planning**—preparing and distributing educational and technical documents, as well as guidance, on the standards of historic preservation planning.

Section 12-47.1-1202, C.R.S., provides specific requirements for the use of State Historical Fund monies, with the minimum requirement being compliance with the U.S. Secretary of the Interior’s standards for treatment of historic properties. Section

12-47.1-1201(2)(a), C.R.S., states that grants are to be provided primarily to governmental or nonprofit entities, although the *Grant Program Guidelines* allow private entities to apply for grant funds through a governmental or nonprofit sponsor.

The following table shows the revenues, expenditures, and fund balance, as well as appropriated full-time equivalent employees (FTE), of the State Historical Fund for the past six years.

<b>State Historical Fund Revenues and Expenditures</b>							
<b>Fiscal Years 1999 Through 2004 (In Millions)</b>							
	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>% Chg.</b>
<b>Beginning Fund Balance</b>	<b>\$31.0</b>	<b>\$36.7</b>	<b>\$41.7</b>	<b>\$48.2</b>	<b>\$56.7</b>	<b>\$58.1</b>	<b>87.4%</b>
<b>Revenues</b>							
Gaming Revenue	\$19.7	\$20.0	\$23.6	\$25.1	\$25.5	\$25.9	31.5%
Interest <sup>1</sup>	\$0.0	\$0.0	\$0.0	\$2.1	\$1.9	\$1.3	NA
Other Revenue	\$0.1	\$0.0	\$0.0	\$0.0	\$0.0	\$0.1	–
<b>Total Revenues</b>	<b>\$19.8</b>	<b>\$20.0</b>	<b>\$23.6</b>	<b>\$27.2</b>	<b>\$27.4</b>	<b>\$27.3</b>	<b>37.9%</b>
Less: Distrib. to Gaming Cities	\$3.3	\$3.9	\$4.0	\$4.7	\$5.0	\$5.1	54.5%
<b>Net Revenue Available to Fund</b>	<b>\$16.5</b>	<b>\$16.1</b>	<b>\$19.6</b>	<b>\$22.5</b>	<b>\$22.4</b>	<b>\$22.2</b>	<b>34.5%</b>
<b>Expenditures</b>							
Grants	\$9.9	\$10.2	\$12.4	\$12.9	\$16.7	\$18.0	81.8%
Society & Museum Operating <sup>2</sup>	\$0.0	\$0.0	\$0.0	\$0.0	\$3.2	\$3.6	NA
Fund Admin. & Indirect Costs	\$0.9	\$0.9	\$0.7	\$1.1	\$1.1	\$1.2	33.3%
<b>Total Expenditures</b>	<b>\$10.8</b>	<b>\$11.1</b>	<b>\$13.1</b>	<b>\$14.0</b>	<b>\$21.0</b>	<b>\$22.8</b>	<b>111.1%</b>
<b>Ending Fund Balance</b>	<b>\$36.7</b>	<b>\$41.7</b>	<b>\$48.2</b>	<b>\$56.7</b>	<b>\$58.1</b>	<b>\$57.5</b>	<b>56.7%</b>
<b>Fund FTE<sup>3</sup></b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>13</b>	<b>18</b>	<b>38.5%</b>
<b>Source:</b> Office of the State Auditor analysis of information from COFRS and the Long Bill.							
<sup>1</sup> In Fiscal Year 2002 the State Treasurer determined that interest should have been accruing to the State Historical Fund and thus began transferring interest to the Fund on cash held at the Treasury. This provision was added to the statutes under Senate Bill 03-193.							
<sup>2</sup> Senate Bill 03-193 added provisions to allow the Fund to pay a portion of the Society's operating expenses.							
<sup>3</sup> Society staff report that FTE were increased by the Colorado Historical Society Board to 18.0 in Fiscal Year 2001 and that these positions were filled mainly during Fiscal Year 2002. This change was not reflected in the Long Bill until Fiscal Year 2004.							

The Society is overseen by a Board of Directors composed of 37 voting members who are elected by members of the Colorado Historical Society. Staff of the Society manage the State Historical Fund, providing detailed assistance with application materials, holding workshops twice each year throughout the State on the grant process, monitoring grants awarded, and providing technical assistance to grant recipients.

## Historical Fund Grants

Administration of the State Historical Fund occurs within the context of a five-year strategic plan developed by the Society. The plan establishes goals for the State's historic preservation community, such as education about proper preservation techniques, the participation by various cultural and ethnic groups in historic preservation efforts, and the exchange of cultural resource information. The Fund also developed some strategic planning priorities specifically for the grant program that resulted from a study conducted in 1998 but found them difficult to operationalize. Since about 2000, the Society has used trends identified by national preservation organizations such as the National Trust for Historic Preservation as a guideline for awarding grants from the Fund.

To fulfill the statutory purposes of the Fund, the Colorado Historical Society has established several types of grants, as described below.

**General Competitive Grants.** These grants include acquisition and development projects, education projects, and survey and planning projects. Applicants may submit their requests to the Society in April and October of each year. The applications are reviewed and scored on a number of criteria, including:

- The public benefit provided by the project.
- The project timing and urgency.
- The degree of community support for the project.
- The amount of leveraged funds. According to the Society's *Grant Program Guidelines*, applicants should provide a cash match equal to at least 25 percent of the total project budget. This requirement may be waived by the Board at the applicant's request.
- The project's relationship to historic preservation and whether the project is consistent with nationally identified trends, such as heritage tourism and historic schools.

In addition, some general grant applications that are determined by staff and the Board to be for high-priority projects are taken out of the competitive process. Earlier phases of these grants have typically been funded through the competitive process prior to being designated high priority. One example of a project that is currently high priority is the Capitol Life-Safety Project, which will update the State Capitol to current safety standards by, among other things, installing an extensive fire alarm, smoke detection, and sprinkler system, and constructing new exit stairs.

**Noncompetitive Grants.** These grants are reviewed by staff to determine the appropriateness of funding but are not competitive with other general grants. The level of funding set aside for noncompetitive grants is established by State Historical Fund staff

based on prior years' experience. Noncompetitive grants generally do not exceed \$10,000 each and include the following:

- **Historic Structure Assessment**—provides funding for the preparation of a report on the physical condition of a historic building or structure.
- **Archaeological Assessment**—provides funding for the collection and evaluation of archaeological information from a site or area in order to create a plan for preservation work.
- **Emergency Grant**—provides assistance to significant resources that are in imminent danger of being lost, demolished, or seriously damaged; threat must be sudden and unexpected.

**Internal Grants.** The Society awards some grant funds each year to be used as “internal” grants for historic preservation projects undertaken by the Society. Internal grants are discussed in greater detail later in the report.

The Board of Directors provides final approval for funding all competitive, high-priority, and internal grants. Society staff have been delegated approval authority for non-competitive grants of less than \$25,000.

## Grant Distribution

From Fiscal Year 1993, the first year grants were awarded from the State Historical Fund, through Fiscal Year 2004, the Colorado Historical Society has awarded over 2,780 grants totaling about \$153.6 million from the Fund, averaging about \$55,100 per grant and \$12.8 million per year. The table below shows the distribution of grant awards for Fiscal Years 2002 through 2004 by grantee type.

<b>State Historical Fund Distribution of Grant Awards by Grantee Type Fiscal Years 2002 Through 2004</b>			
<b>Grantee Type</b>	<b>Amount Awarded (In Thousands)<sup>1</sup></b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Nongovernmental Entities	\$8,860	\$4,728	\$5,990
State Agencies	\$352	\$2,558	\$6,483
Municipalities	\$1,889	\$2,990	\$2,330
Local Historical Societies <sup>(2)</sup>	\$2,010	\$2,106	\$3,551
Colorado Historical Society (Internal)	\$1,834	\$3,043 <sup>(3)</sup>	\$898
Counties	\$1,273	\$1,632	\$1,539
Colleges/Universities	\$919	\$770	\$926
School Districts	\$168	\$207	\$483
Special Districts	\$156	\$353	\$168
Other <sup>(4)</sup>	\$446	\$1,358	\$855
<b>Total</b>	<b>\$17,907</b>	<b>\$19,745</b>	<b>\$23,223</b>
<p><b>Source:</b> Office of the State Auditor analysis of State Historical Fund data.</p> <p><sup>1</sup> Amount awarded includes all grants awarded regardless of whether the grant was ultimately declined by the grantee or rescinded by the Board.</p> <p><sup>2</sup> Includes some organizations that may be affiliated with municipalities.</p> <p><sup>3</sup> Includes one large internal grant that was awarded then declined for a net internal grant award total of \$1.8 million for Fiscal Year 2003.</p> <p><sup>4</sup> Includes organizations such as the Ute Mountain Ute Tribe and Naropa University, as well as covenants, increased awards, and easements paid out of grant funds.</p>			

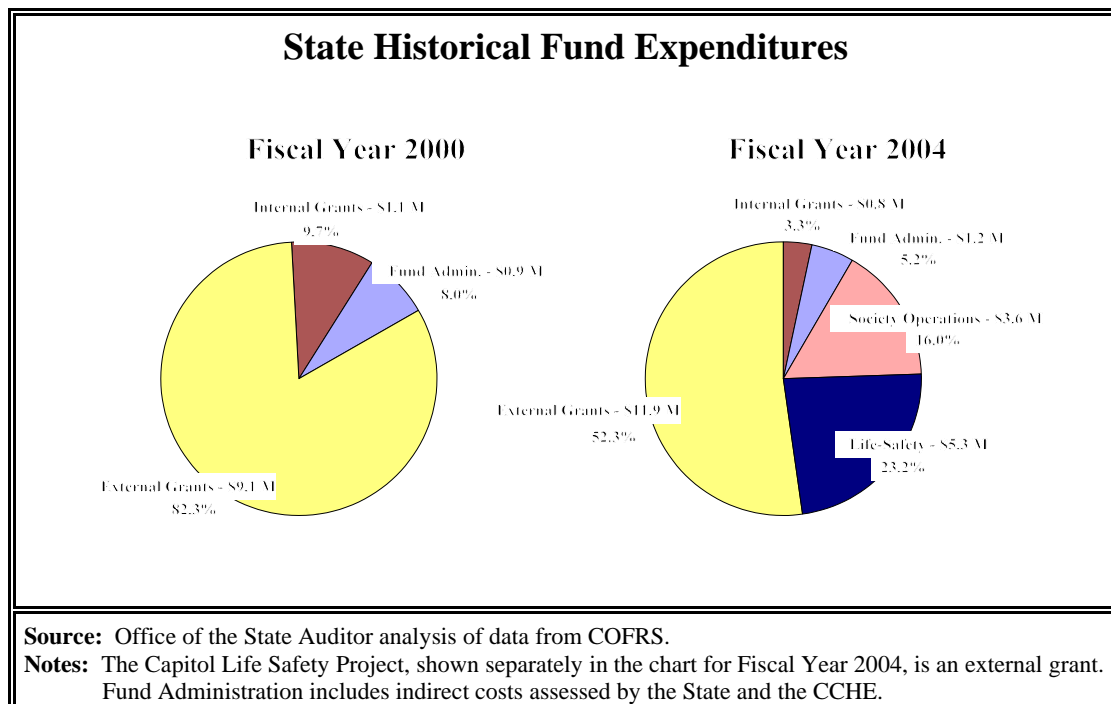
## Audit Scope and Methodology

The purpose of this performance audit was to evaluate the Colorado Historical Society’s management and oversight of grant monies administered through the State Historical Fund. As part of the audit, we evaluated the Society’s administration of the Fund, examined a sample of grant files maintained by the Society and by grant recipients, and evaluated the Society’s grant contracting and oversight processes.

# Management of the State Historical Fund

## Chapter 1

The primary purpose of the State Historical Fund (the Fund) is to provide grants for a variety of historic preservation purposes such as identifying historical structures that should be preserved, providing education and technical assistance regarding preservation, and carrying out preservation and restoration activities on historic structures and locations. The amount granted to organizations outside the Colorado Historical Society (the Society) varies annually, but the proportion of total expenditures from the Fund that has been used for external grants has generally decreased over the past five years. As the following pie charts show, the proportion of the Fund's total expenditures for external grants has dropped from 82 percent in Fiscal Year 2000 to 52 percent (excluding the Capitol Life-Safety Project) in Fiscal Year 2004. This excludes the automatic annual distribution to the gaming cities.



Because the monies available for historic preservation projects are limited, it is important for the Society to manage the Fund as efficiently as possible. We noted

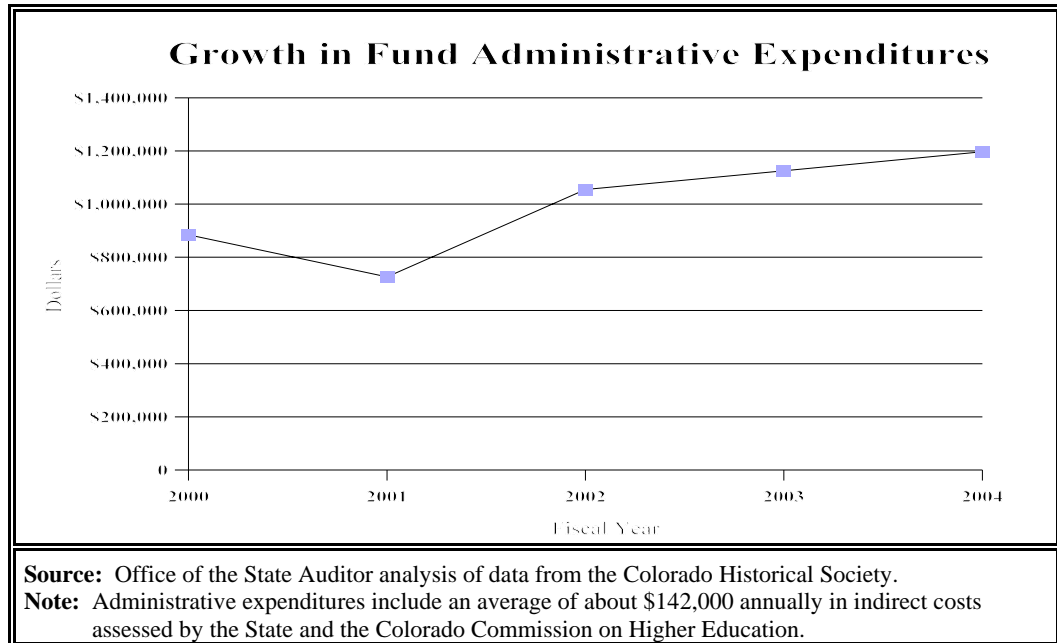
the following areas in which the Society may not be maximizing the funds available for historic preservation grants.

## **Operating and Administrative Costs**

One of the primary reasons the proportion of the Fund spent on external grants has decreased is that monies from the Fund began covering a portion of the Society's operating costs in Fiscal Year 2003. These funds are appropriated by the Legislature and replace General Fund monies that had been appropriated to the Society in prior years. As will be discussed in more detail in a later section, the amount of State Historical Fund monies appropriated for Colorado Historical Society operations grew about 36 percent, from \$2.8 million in Fiscal Year 2003 to \$3.8 million in Fiscal Year 2004. In addition, beginning in Fiscal Year 2005, the Judicial Department is receiving an appropriation from the State Historical Fund to cover maintenance, custodial, and security services provided by Judicial to the facilities housing the Colorado History Museum. This appropriation has historically been funded with General Fund monies appropriated to Judicial. The Fiscal Year 2005 appropriation totals about \$380,000 out of the State Historical Fund.

Another factor affecting the percentage of the Fund available for external grants is the amount spent on administering the grant program. As the following chart shows, the Fund's administrative expenditures have increased by about a third over the past five years, from about \$885,000 in Fiscal Year 2000 to about \$1.2 million in Fiscal Year 2004. State Historical Fund staff report that the increase in administrative expenditures between Fiscal Years 2001 and 2002 was primarily due to the addition of five staff, including technical staff, administrative support, and public relations positions. The increase in administrative costs reduces the amount of Fund monies available for grants.





The General Assembly does not appropriate a specific line item for administration of the Fund. According to Section 12-47.1-1201(3), C.R.S., the Society is authorized to expend a portion of the State Historical Fund “to cover such reasonable costs as may be incurred in the selection, monitoring, and administration of grants for historic preservation purposes. The society may employ such personnel . . . as may be necessary to fulfill its duties . . .” in administering the Fund.

Although the Society reports its administrative costs for managing the grant program in its annual report, it does not show a trend of the increase in administrative costs. Given the Society’s ability to use a portion of the Fund for administering the grant program without a specific appropriation, and in light of the increases in the Fund’s administrative costs over a period when other state expenditures were limited, we believe the Society should include in its annual report trend information for at least three years on the administrative costs of the Fund. Reporting this type of information is important so that all stakeholders, including the historic preservation community and the General Assembly, can ensure that limited historic preservation dollars are being maximized for grant-making purposes.

## Internal Grants

In addition to administrative costs, the Fund provides monies for internal grants for projects carried out by other divisions within the Society. Annually, Society division directors prioritize internal grant projects and apply for funding from the State Historical Fund. Internal grant applications are reviewed by the Board’s Archaeology and Historic Preservation Committee, and the Board approves their

funding. Annual funding limits for internal grants, which do not compete with other general grant requests for funding, are established by the Finance and Audit Committee of the Board.

Before Fiscal Year 2003, internal grants paid for a variety of activities, including funding some staff positions in the Society, maintaining a historic resource database, and conducting construction and rehabilitation of historic properties and museums operated or owned by the Society. In 2003 the General Assembly passed Senate Bill 03-193, which allows State Historical Fund monies to be used for the operating costs of the Society, stating:

In accordance with . . . the State Constitution, the General Assembly hereby determines that it is appropriate to provide funding for the State Historical Society through the State Historical Fund. The use of a portion of the State Historical Fund for the support needs of the State Historical Society is consistent with the preservation purposes of the Fund and of the Society.

The bill also appropriated about \$2.8 million of State Historical Fund monies to fund some Society operating costs and eliminated a General Fund appropriation to the Society in the same amount.

In Fiscal Years 2004 and 2005, the General Assembly increased the amount of Historical Fund monies appropriated to pay for a portion of the Society's operating costs to about \$3.8 million each year. According to staff, internal grants that traditionally had paid for some ongoing personal services and operating expenses within the Society were rolled into this appropriation. As a result, the amount of funds devoted to internal grants decreased from about \$1.8 million in Fiscal Years 2002 and 2003 to about \$899,000 and \$921,000 in Fiscal Years 2004 and 2005, respectively.

State Historical Fund staff report that since the changes made by Senate Bill 03-193, the intent of the Board is to award internal grants primarily for discrete projects rather than to fund a portion of ongoing Society operations. However, the Society has not translated this intent into any specific written criteria or guidelines for internal grants. With an increased appropriation for Society operations, we believe this is an appropriate time for the Society to consider whether to include all internal grants in its operations appropriation. If the Society determines that internal grants should continue to be funded as grants from the Fund, it should establish criteria that clarify that internal grants are no longer intended to be available to fund ongoing operations. The Society could then consider whether to return internal grants to the competitive process or appoint independent, external reviewers to review and comment on all internal grant applications.

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## **Recommendation No. 1:**

The Colorado Historical Society should take steps to ensure the funds available for external grants are maximized by either:

- a. Formalizing criteria for awarding internal grants in writing and either including internal grants in the competitive process or sending all internal grants to an external, independent reviewer for comment, or
- b. Including all internal grants in the annual appropriation made from the Fund for the Society's operations.

The Society should also include, in its annual report, trend information for at least three years on the costs of administering the Fund.

## **Colorado Historical Society Response:**

Agree. Implementation date: April 2005. The Board's existing internal grant policy will be revised by April 2005 to include the Colorado Historical Society's current practice of not using internal grants for ongoing operations. That policy includes review, vetting and prioritization by Board committees, review by Colorado Historical Society Division Directors, consideration by the Board's Finance and Audit Committee, development of recommendations by the Board's Archaeology and Historic Preservation Committee, and review by the full Board of Directors. But further efforts will be made to obtain external review of internal grant applications beginning in the spring 2005 grant round.

The Colorado Historical Society is proud of its success in maintaining administrative costs, excluding indirect cost assessments, of this program at or below 5 percent of the amount distributed. As this audit report indicates, while State Historical Fund net revenues increased 35 percent between 1999 and 2004, administrative costs over the same period increased by only 33.3 percent. We will include a report on this success in the Colorado Historical Society Annual Report for Fiscal Year 2005. It should also be noted that salary, travel costs associated with project inspections, and office rental costs (necessitated by the lack of vacant state-owned office space in proximity to the Colorado Historical Society main offices) constitute approximately 90 percent of the State Historical Fund's administrative overhead.

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## Profit-Generating Grants

According to the Society, some grants are for projects that generate revenues, such as for publications that are sold to the general public. We reviewed one high-priority external grant for a yearly conference related to historical preservation in Colorado that generated a profit in 2003 and 2004. This statewide conference attracts about 750 attendees per year, including preservationists, architects, planners, and historians, and focuses on education, advocacy, and technical assistance for historic preservation efforts. The grant award for the conference has risen from about \$30,000 for the Calendar Year 2000 conference to nearly \$54,000 for the Calendar Year 2004 conference for a total of \$216,000 over that period.

We obtained detailed records of revenues and expenditures from the grantee for 2003 and 2004 and found that the conference generates revenues from sponsorships, entrance fees, and merchandise sales in addition to the annual grant from the Society. We found that for 2003 and 2004, the conference generated revenues that were sufficient to cover most or all of its costs. As the following table shows, the Society could have reduced the grant award of \$47,700 for 2003 by about 90 percent (to \$6,300), and the conference would have broken even. In 2004 the grantee would have had a profit of about \$4,200 without any grant from the Society.

<b>State Historical Fund Annual Conference Revenues, Expenditures, and Grant Awards Calendar Years 2003 and 2004</b>		
	<b>2003</b>	<b>2004</b>
Conference Revenue Including State Historical Fund Grant	\$183,421	\$198,999
Less: Conference Expenditures	\$142,013	\$141,206
Profit (Loss) With Grant	\$41,408	\$57,793
Less: State Historical Fund Grant	(\$47,700)	(\$53,600)
<b>Profit (Loss) Without Grant</b>	<b>(\$6,292)</b>	<b>\$4,193</b>
<b>Source:</b> Office of the State Auditor analysis of unaudited financial reports provided by the grantee.		

According to the Society, the conference provides benefits to Colorado's historic preservation community and, as such, is an appropriate and valuable use of grant funds. In addition, the grantee reports that the profit generated from the conference is used to provide matching funds toward another program supported by the Society. Currently, the Society does not request information on additional revenues from any grantee to evaluate whether the grant helps the recipient generate a profit. However, since the amount of funds available for grants is limited, the Society should obtain assurances from grantees that any profits generated from grant-funded projects will be used to carry out other historic preservation activities.

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## **Recommendation No. 2:**

The Colorado Historical Society should improve its policies related to funding grants that generate a profit for the grantee by:

- a. Requiring grantees to report whether they will generate a profit from grant-supported projects.
- b. Requiring grantees that report a profit to certify that such funds will be used to further their historic preservation missions.

## **Colorado Historical Society Response:**

Agree. Implementation date: January 2005. The positive economic benefits of historic preservation are well illustrated by the fact that some State Historical Fund funded projects do turn a profit. If that profit takes the form of increased property values, then the profit can be recouped by requiring that grants be repaid on the sale of the property. But when the profit takes the form of increased conference attendance fees or book sales, it is in the State's best interest to require that the profit be allocated toward furthering the grant recipient's historic preservation mission. This has been the policy of the Fund for many years, but has not been stated clearly in the grant application handbook. That oversight will be corrected in the next issue of that handbook, printed in January of 2005. The policy will also be included in the revised contracts manual by the end of Calendar Year 2004.

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## **Uncommitted Funds**

We found the Society has not established adequate processes and policies to ensure that available monies in the Fund are distributed as quickly as possible through the grant-making process. As a result, the State Historical Fund has carried an uncommitted fund balance at the end of each of the past four fiscal years ranging from about \$5 million to almost \$9 million, or about 9 to 15 percent of the total fund balance. The table below shows the breakdown of the year-end fund balance in the State Historical Fund since Fiscal Year 2001.

<b>State Historical Fund Analysis of Year-End Fund Balance (In Millions) Fiscal Years 2001 Through 2004</b>								
<b>Fund Balance</b>	<b>2001</b>		<b>2002</b>		<b>2003</b>		<b>2004</b>	
	\$	%	\$	%	\$	%	\$	%
Encumbered <sup>1</sup>	\$18.1	37.5%	\$25.6	45.1%	\$24.0	41.3%	\$26.5	46.2%
Reserved <sup>2</sup>	\$23.6	48.9%	\$25.1	44.3%	\$25.5	43.9%	\$25.9	45.1%
Uncommitted <sup>3</sup>	\$6.6	13.6%	\$6.0	10.6%	\$8.6	14.8%	\$5.0	8.7%
<b>Total Fund Balance</b>	<b>\$48.3</b>	<b>100.0%</b>	<b>\$56.7</b>	<b>100.0%</b>	<b>\$58.1</b>	<b>100.0%</b>	<b>\$57.4</b>	<b>100.0%</b>

**Source:** Office of the State Auditor analysis of data from COFRS.

<sup>1</sup> Amount of grant awards approved by the Colorado Historical Society's Board of Directors but not yet paid to grantees.

<sup>2</sup> Amount of receivable at fiscal year-end from limited stakes gaming. This is reserved to fund the subsequent year's appropriations and expenditures.

<sup>3</sup> Uncommitted balance may include an amount of funds rolled forward for internal grants. Due to the way internal grants are accounted for in COFRS it is difficult to determine a precise amount.

In the table above, “encumbered” fund balance represents grant awards that have been approved by the Society’s Board of Directors but not yet paid to grantees. The “reserved” fund balance represents the amount owed to the State Historical Fund from limited stakes gaming proceeds at the end of the fiscal year; this amount is the basis for the Fund’s appropriation in the State’s annual budget, or Long Bill, which will be used to fund expenditures in the subsequent fiscal year. The uncommitted fund balance is the residual amount after accounting for these two types of obligations and represents funds that could be used to fund additional projects.

We identified two ways in which the Society could improve cash management practices and help ensure that the use of available resources is maximized. First, the Society has not determined a minimum year-end uncommitted fund balance that should be maintained in the Fund. The uncommitted fund balance should represent the resources available in the Fund for unexpected costs and contingencies, such as grant increases due to cost overruns or lower than anticipated revenue. To balance the goal of funding as many eligible projects as possible with the need to provide for contingencies, the Society should establish a methodology for determining a target uncommitted fund balance for the Fund.

Second, the Society does not have adequate budgetary and cash management processes to identify the uncommitted fund balance that is available for each grant round and accurately budget for the grant award process. A number of factors can influence the level of the Fund’s uncommitted fund balance including the dollar amount of new grants awarded, increased funding awarded to previously approved grants, and returns of monies to the Fund due to rescinded or declined grants or projects that have been completed under budget. While the bulk of new grants are awarded in two rounds per year, other factors affecting uncommitted fund balance,

such as returns to the Fund, can occur anytime during the year. Proper monitoring of uncommitted fund balance, especially as each grant round approaches, helps ensure that the Society has accurate information on the amount of funds available for grants.

To determine the amount available for grants in each grant round, the Society develops a budget that takes into account anticipated revenue to the Fund as well as estimated expenditures including the Society's administrative costs; awards for internal grants; allowances for grant increases; and an estimated amount of uncommitted fund balance, or resources, from the prior year. Based on this budget, Society staff calculate the total monies available for external grants for each round. We reviewed these budgets for the past five grant rounds and found the budgets did not accurately identify uncommitted funds that could be used for grants for a number of reasons, including the following:

- The budgets did not include accurate figures for uncommitted funds carried forward from the prior year. According to Society staff, this amount is estimated annually. However, the estimate is derived before the end of the fiscal year and should be reconciled to the State's accounting system, COFRS, after the close of the fiscal year when the final uncommitted fund balance is known. For instance, staff estimated that the uncommitted fund balance at the end of Fiscal Year 2003 would be \$7.5 million, and this estimate was used in preparing the Fiscal Year 2004 budget. However, the actual amount in COFRS was \$8.6 million after the close of the fiscal year, and the budget was not adjusted to reflect the additional \$1.1 million available.
- The budgets include interest earned from the prior fiscal year. For instance, the interest revenue budgeted for Fiscal Year 2004 was based on interest earnings in Fiscal Year 2003. Because interest earnings declined between Fiscal Years 2003 and 2004, the original budget overestimated interest earnings by about \$713,000 for Fiscal Year 2004. Since interest accrues to the State Historical Fund monthly, the budget should be updated during the year to reflect actual interest earned and should be based on estimates of current fiscal year interest revenues.
- Actual expenditures came in below budget for certain budget categories, such as Fund administration and Society operations. For Fiscal Years 2003 and 2004, we found the actual expenditures came in below budget by an average of about \$390,000 each year (about 8 percent), contributing to the end-of-year balance of uncommitted funds.
- One of the budgets did not include amounts that had been previously awarded but subsequently unencumbered, such as when a grant award was

declined by the grantee. For instance, we identified a grant of about \$155,000 that was awarded in the first round of 2004, but was subsequently declined and returned to the fund prior to the second grant round. Identified returns to the fund should always be included as available funds in the budget for the subsequent grant round.

These problems mean that the information used by the Society as the basis for determining funds available for grants has not been as accurate as it could be and likely has contributed to the existence of a significant uncommitted fund balance at the end of each fiscal year.

Accurately tracking uncommitted funds is important because there are insufficient funds to support all historic preservation projects. The following table shows that, on average, the Society has awarded about 70.5 percent of the grant amounts requested each year, leaving an average of about \$7.5 million in projects unfunded annually.

<b>State Historical Fund Grant Activity (In Millions) Fiscal Years 1999 Through 2004</b>				
<b>Year</b>	<b>Grants Requested</b>	<b>Grants Awarded</b>	<b>Grants Denied</b>	<b>Awarded as % of Requested</b>
<b>1999</b>	\$21.5	\$13.8	\$7.7	64.2%
<b>2000</b>	\$27.5	\$14.7	\$12.8	53.5%
<b>2001</b>	\$25.4	\$18.1	\$7.3	71.3%
<b>2002</b>	\$19.8	\$17.9	\$1.9	90.4%
<b>2003</b>	\$27.6	\$19.7	\$7.9	71.4%
<b>2004</b>	\$30.5	\$23.2	\$7.3	76.1%
<b>Avg.</b>	<b>\$25.4</b>	<b>\$17.9</b>	<b>\$7.5</b>	<b>70.5%</b>
<b>Source:</b> Office of the State Auditor analysis of data from the Colorado Historical Society.				

In addition to improving the budgeting process and tracking the uncommitted fund balance, the Society should establish a methodology for determining the amount of uncommitted fund balance that should be maintained in the Fund to cover unforeseen events. For example, state statutes require the Division of Gaming, which is responsible for overseeing gaming casinos in the State and collecting taxes on gaming revenues, to reserve the equivalent of administrative expenditures for the last two months of the fiscal year prior to determining the amount to be distributed to the various recipients of gaming proceeds, such as the State Historical Fund.



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### **Recommendation No. 3:**

The Colorado Historical Society should improve management of resources available to the State Historical Fund by:

- a. Establishing a reserve amount to be maintained for the uncommitted fund balance and reducing the level of uncommitted fund balance to an appropriate level on the basis of qualifying applications received.
- b. Improving the budgeting process by refining estimation procedures for expenditures and interest revenues; determining funds available from denied, rescinded, and under-budget grants; and reconciling the uncommitted fund balance used in the budget to COFRS.

### **Colorado Historical Society Response:**

- a. Agree. Implementation date: January 2005. It is the current policy of the State Historical Fund to award all available funds within each fiscal year. Because returns, rescissions and declines all occur daily, while the competitive grant process awards grants twice each year, it is very difficult to reach the end of the year with a premeditated balance. One emergency grant award or one declined grant at the end of the fiscal year could prevent this from happening. But we will set a reserve amount in January of 2005 and make every effort to meet our goal.
- b. Agree. Implementation date: Ongoing. Many of these things are already being done, but could be done more consistently. This will be an ongoing effort beginning with the January, 2005 grant round.

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## **Timely Use of Grant Awards**

Another area in which the Society is not ensuring the most effective use of resources concerns the timely disbursement of encumbered funds. We found delays in how quickly funds are expended once they are committed to specific grants. As the table below shows, because of increasing revenues and grants awarded, grant encumbrances increased almost 47 percent while year-end operating cash increased about 24 percent between Fiscal Years 2001 and 2004.

<b>State Historical Fund</b>					
<b>Encumbered Grants, Uncommitted Fund Balance, and Operating Cash</b>					
<b>As of June 30, 2001 Through June 30, 2004</b>					
	Fiscal Year				% Change
	2001	2002	2003	2004	
Encumbered Grants	\$18.1	\$25.6	\$24.0	\$26.5	46.4%
Uncommitted Fund Balance	\$6.6	\$6.0	\$8.6	\$5.0	-24.2%
<b>Total Encumbered Grants and Uncommitted Fund Balance</b>	<b>\$24.7</b>	<b>\$31.6</b>	<b>\$32.6</b>	<b>\$31.5</b>	<b>27.5%</b>
Total Operating Cash <sup>1</sup>	\$25.9	\$32.6	\$33.5	\$32.0	23.6%
<b>Source:</b> Office of the State Auditor analysis of data from COFRS.					
<sup>1</sup> Operating cash less warrants payable.					

## Project Management

One factor that contributes to the State Historical Fund's end-of-year cash and fund balances is grants which have been awarded but are not yet under contract. We reviewed information for the Fund and found that as of mid-July 2004, there were 17 grants totaling more than \$1.7 million that had been awarded at least six months earlier but had not yet been placed under contract. Specifically, we found:

- Six grants worth a total of approximately \$540,000 had been encumbered for over two years.
- Three grants worth a total of about \$370,000 had been encumbered between one and two years.
- Six grants worth a total of about \$690,000 had been encumbered between six and twelve months.
- Two grants worth a total of about \$125,000 had not been encumbered due to lack of sufficient documentation provided by the grantee.

Although the Society encumbers, or commits, funds at the time the grant is approved by the Board of Directors, grantees are required to sign contracts before grant-qualifying work can begin and grant funds can be disbursed. There are many factors that can delay finalization of a contract, including property ownership issues, grantees' efforts to raise cash match, and the failure of grantees to provide timely documentation to execute a contract. While most of the factors affecting how quickly a contract is executed are out of the Society's control, the Board can choose to rescind a project that is not making adequate progress. Grant staff report that they monitor these projects and periodically submit projects for the Board to consider

rescinding if there have been significant delays. Over the past five years, the Board has rescinded seven grants totaling about \$642,000 in grant awards.

Currently the Society has no formal requirements regarding when, or how frequently, the Board should review grant awards to determine if projects have been unacceptably delayed. We found one grant that was delayed more than three years before Society staff referred it to the Board for review. This grant of \$316,000 was awarded in January 2001 and was finally sent to the Board for reconsideration in March 2004 because it had not gone under contract. Although in this case the Board voted to maintain the grant award, over \$300,000 in funds was unavailable for other projects over the course of more than three years without any reconsideration of the grant. Without established time frames for reconsidering grants that are delayed, the Society may be unnecessarily tying up State Historical Fund resources that could be used to fund other projects.

## **Project Control**

Another reason for the buildup in the Fund's end-of-year operating cash and encumbered grant awards is that the Society typically encumbers projects in the year the grant is awarded. Once encumbered, grant funds are generally disbursed in three payments—an advance payment of 40 percent, an interim payment of 50 percent, and a final payment of 10 percent. Many projects, especially those that involve actual restoration or physical preservation of a historic structure or site, take a number of years to complete. Depending on a variety of factors, including how quickly the project is put under contract, how quickly the project is started and eventually completed, and how quickly the grantee provides documentation required for payment, most of the funds for a project may not be disbursed to the grantee until a few years after the grant has been awarded. For example, as of June 30, 2004, more than one-quarter of the projects (21 of 75) awarded almost a year earlier, in July 2003, had received no disbursements from the State Historical Fund. These 21 grants were worth about \$1.9 million.

The Society has used a phased approach to funding in some instances. One large project that the Historical Society has arranged to encumber on a year-by-year basis is the Capitol Life-Safety Project. The Society has made an informal commitment to the State to fund this project for a total estimated cost of \$30 million from Fiscal Years 2003 through 2008, as shown below.

<b>Capitol Life-Safety Project Funding (In Millions)</b>						
<b>Fiscal Years 2003 Through Fiscal Year 2008</b>						
<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Total</b>
\$2.3	\$5.9	\$6.8	\$4.5	\$4.5	\$6.0	\$30.0
<b>Source:</b> Department of Personnel and Administration, Buildings and Real Estate Programs.						

The Colorado Department of Personnel and Administration, which oversees the Life-Safety Project, will apply for these funds on an annual basis. Each application is for a discrete scope of work designated by contract and each phase of the project will have stand-alone value. By meeting these criteria, the Fund can encumber each phase of the project as it is awarded.

Currently the Society's *Guidelines* for the Fund state that external grant projects should be limited to 18 months and that grants typically range up to about \$200,000. Projects to physically preserve and/or restore historical structures and sites often involve higher costs and may take several years to complete. We reviewed information from the Society and estimated that, excluding the Capitol Life-Safety Project, 106 of the 256 grants awarded in Fiscal Year 2004 (about 41 percent) were for physical preservation and restoration projects. These 106 grants totaled \$12.3 million, or an average of about \$115,800 per project. Of these, 14 grants (about 13 percent) exceeded \$200,000 and 14 also had contracts exceeding 24 months in length.

Staff of the Fund report that during the application process they encourage grant applicants to evaluate their projects, particularly those that are high cost and lengthy, for segmentation into discrete stand-alone phases. However, the Society's *Grant Guidelines* do not make clear that grantees, based on established criteria, should evaluate their projects for possible segmentation. Segmenting projects so that funding is approved as each segment is ready to start would allow the Society to phase the funding of the entire project over a number of fiscal years. Phased funding allows for a more efficient use of monies by more closely matching revenues and expenditures.

One way to promote the phasing of projects is to develop criteria by which both the Society's technical staff and the grant applicants could evaluate the suitability of projects for segmentation into stand-alone phases. These criteria should be communicated to grantees in the *Guidelines* and could incorporate the 18-month scope of work and \$200,000 grant amount currently suggested in the *Guidelines*. For those projects that meet the established criteria, applicants could be required to apply for funding periodically as one phase of the project is completed and another is ready to begin, rather than requesting all funds up front. In this way, projects would be segmented whenever possible and the Society could encumber each phase individually, subject to the availability of funds, rather than all phases of the project

at once, thereby leaving more funds available to start additional projects. It should be noted that the more expensive a project is and the longer it will take to complete, the greater the potential benefits of using a phased funding approach, since relatively more spending authority remains available to start new projects.

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### **Recommendation No. 4:**

The Colorado Historical Society should improve its cash management by:

- a. Formalizing and enforcing criteria to identify projects that could be funded in phases and amending its grant guidelines in accordance with these criteria.
- b. Establishing policies that require periodic review by the Board of the grant awards in which contracts have not been executed with the Society within a reasonable time frame.

### **Colorado Historical Society Response:**

- a. Agree. Implementation date: January 2005. It is part of the standard advice given to all grant applicants that large projects should be broken into phases that can be completed within 18 months. This policy will be clarified in the next issue of the grant application handbook, printed in January of 2005. However, this may not result in an increase in the number of grant awards or in quicker distribution of grant funds. Grant funds can only be disbursed as grant recipients complete assigned tasks, in accordance with the terms of their contract.
  - b. Agree. Implementation date: November 10, 2004. All projects not yet under contract will be reported to the Board of Directors annually with an explanation of their current status and a request for Board action.
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# Grant Oversight

## Chapter 2

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The Colorado Historical Society (the Society) has developed a *Grant Application Handbook*, *Grant Program Guidelines*, and a *Grant Manual*, which explain the program's administrative policies and procedures as well as the application and award processes. In accordance with the *Grant Manual*, grant recipients must submit financial reports (typically one interim and one final) to the State Historical Fund (the Fund) to document grant project expenses. In addition, grant program staff periodically conduct desk audits of the grants, using documentation maintained and submitted by the grantees. Staff review the documents to ensure that reported expenditures are accurate and appropriate.

As part of our review, we chose a risk-based sample of grants to evaluate. This sample included seven grants we reviewed at on-site grantee locations, as well as an additional eight grants that the Society considered high-risk. We reviewed grant files at the Society and obtained information directly from grant recipients. We noted several areas in the grant program that need improvement, particularly with regard to financial reporting by grantees and the grant guidance provided by the Society.

### Administrative Grant Charges

According to the *Application Handbook*, work that is not eligible to receive grant funds also may not be proposed as cash match on a grant-funded project. However, we found that the *Grant Program Guidelines* are unclear with respect to whether administrative or indirect costs can be charged to either grant funds or cash match. The *Grant Program Guidelines* recommend that grant management, administrative, and indirect costs be limited to 15 percent of the project's costs and be reported as cash match and require that requests for grant funding of administrative costs be justified by the grantee. In addition, the *Guidelines* state that if an employee of the grantee acts as manager of a project, the grant may only cover the costs associated with the time the employee spends performing such management duties. Since the *Guidelines* do not provide any specific guidance on how the amount charged for administration should be determined or documented, they do not provide sufficient information to grantees to ensure that administrative costs are allowable and reasonable.

We reviewed one project in which the grantee reported \$6,400 in administrative costs for project supervision provided by the grantee's president. During the period of the grant project, the president's hourly wage plus benefits was around \$19 per hour but the grantee charged \$50 per hour to the project for the president's supervisory time, more than double his typical compensation rate. The grantee reported that had they contracted out for the services, they would have had to pay as much or more. However, the president was not paid \$50 per hour by the organization for his time supervising the project. Although the administrative costs did not exceed 15 percent of the project's cost, the grantee charged an excessive amount for the president's time. The grantee reported that the \$50 per hour included some indirect costs incurred by the organization but was unable to provide supporting calculations for the \$50 rate. The grantee also was unable to provide time sheets indicating the number of hours worked by the president or the nature of the work performed.

According to the *Grant Application Handbook* and *Grant Program Guidelines* an actual money transaction must take place in order for expenses to be considered cash match. Since the *Grant Program Guidelines* recommend that grant administration costs be reported as cash match, this suggests that only actual costs incurred by the organization for management and administration of the grant are reportable. Good criteria regarding the allowability and allocability of grant management and administrative costs can be found in OMB Circular A-122 for federal grants to nonprofit organizations, OMB Circular A-87 for federal grants to local governments, and Article 107 of the Colorado Procurement Code. Clarifying the guidelines regarding the basis for charging administrative costs and the type of supporting documentation that should be maintained could help prevent excessive charges in the future.

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### **Recommendation No. 5:**

The Colorado Historical Society should amend the grant guidelines to clarify that administrative charges should reflect actual costs incurred by the organization for administration of the grant and that grantees should maintain adequate documentation to substantiate the expenses.

### **Colorado Historical Society Response:**

Disagree. The Colorado Historical Society has chosen to adopt and implement a model of fixed percentage for administrative overhead, as used by the National Park Service for historic preservation grants. This system has worked very well. Costs of administration are simply required to be not more than 15 percent of the amount of the grant, and larger requests require

additional justification. This system takes into consideration the fact that the salary of a staff person assigned to administer a grant is not the only cost incurred by the grant recipient. In addition to office overhead, equipment, and contracted services, there are risks that cannot be easily quantified. For example, grant recipients for third parties are agreeing to be legally liable for that third party's mistakes, and can be called upon to fix the problem or to return the grant funds with interest. Requiring each individual grant recipient (many of whom are not sophisticated in the art of accounting) to compute indirect costs and to be prepared to defend that computation during an audit would increase the staff time necessary to conduct audits, resulting in increasing costs of administration, using any savings that might otherwise be realized.

### ***Auditor's Addendum:***

***As discussed throughout the report, there are insufficient monies available to fund all the historic preservation projects that seek support from the State Historical Fund. Due to the limited funding, it is important for the Society to ensure that grant monies awarded are used only for reasonable and necessary expenses associated with the grant projects. By requiring that administrative costs charged to the grants include only actual amounts needed to administer the grant, the Society is helping to reduce the risk of errors or irregularities in the expenditure of grant funds and maximize the monies available to other grantees.***

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## **Grant Documentation**

The Society's *Grant Manual* requires grant recipients to maintain all documents relating to project expenditures for a period of three years. For many projects, the grantees contract with professionals such as architects and general contractors to carry out specific project tasks. These contractors submit invoices to grantees for all expenditures on the project, and the grantee must maintain these invoices. However, we found that the Society does not provide direction on the level of detail needed on the invoices provided by contractors to grantees.

As part of our review of a risk-based sample of grant files, we examined the documentation maintained by grantees for 15 grants to evaluate whether the documentation adequately supported project expenses. We noted that many of the invoices provided were vague and only listed task descriptions, such as "project management" and "plumbing." Specifically, for 9 of the 15 grants we reviewed (60 percent), at least some invoices lacked basic information such as labor rates, quantity of labor, material rates, and the quantity of material used. It is important for grantees



to obtain detailed cost information on their grant projects so that the Society can ensure the State is not being overcharged and can appropriately monitor grant expenditures.

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### **Recommendation No. 6:**

The Colorado Historical Society should clarify the grant guidelines to require that grantees maintain detailed invoices with basic cost information, such as cost of material per unit, quantity of materials, hours of labor worked, labor rates, and mark-ups.

### **Colorado Historical Society Response:**

Agree. Implementation date: January 2005. The next issue of the grant application handbook printed in January of 2005 will state that grantees are required to obtain detailed invoices, which is the industry standard. The contracts manual will also include this information by the end of Calendar Year 2004. However, it should be noted that desk audits are performed after the fact. Since contractors are not parties to the State Historical Fund contract, if they have failed to provide adequate invoices to their customers, the State's only recourse will be to demand repayment of the grant from the grant recipient or to take this lapse into consideration when processing future grant applications from that organization. Also note that the statistic in the audit report was based exclusively on grant files already identified by the State Historical Fund staff as being problematic. Since detailed invoices are the industry standard, it is unlikely that this is a common issue on less problematic projects.

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## **Competitive Bidding**

The Fund's *Grant Manual* requires that "grant recipients use a fair and open selection process to obtain the best possible price for the desired product and avoid any appearance of conflict or favoritism." The *Manual* also requires that grant recipients "maintain and be able to provide sufficient documentation verifying that a fair and open [selection] process was used." The *Manual* suggests that grantees use Requests for Qualifications (RFQs) or Requests for Proposals (RFPs) to select contractors. However, we found that some grant recipients in our risk-based sample did not advertise or competitively bid their projects.

For 7 of the 15 grants we reviewed (47 percent), the grantees did not competitively bid work on the project. Although 2 of these were small grants ranging from \$10,000 to \$45,000, the other 5 grants were for more expensive projects costing more than \$50,000 each. For 4 of the 7 grants that were not competitively bid, we were unable to obtain sufficient documentation, such as a list of contractors solicited, indicating that a fair and open selection process was used.

We found that some other states require formal bidding for recipients of historical project grants. For instance, Michigan requires that “all work over \$10,000 must be advertised for bids in one or more newspapers in general circulation.” In addition, Georgia requires that total project contract costs in excess of \$100,000 be formally advertised. According to the *Colorado State Buildings and Real Estate Division’s Policies and Procedures* for small construction purchases, projects costing more than \$25,000 must solicit quotes for the work, and according to statutes, projects costing more than \$150,000 require the solicitation to be published in a local newspaper. While State Historical Fund grants are exempt from the state procurement code regarding bidding processes and vendor selection, it is good business practice to require that grantees use a formal bidding process. Bidding helps to ensure that limited state funds are spent cost-effectively, avoid conflicts of interest in the selection of contractors, and ensure only arms-length transactions are paid for with grant funds. The Society should establish a threshold above which projects must be advertised and competitively bid to help reduce project costs and ensure that grant-funded work is done by qualified professionals.

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### **Recommendation No. 7:**

The Colorado Historical Society should require grantees to use a competitive bidding process for project work if the grant award exceeds a pre-determined threshold. For projects below the threshold, the Society should require grantees to certify that a fair and open selection process was used and to maintain written justification for the contractor selected.

### **Colorado Historical Society Response:**

Agree. Implementation date: January 2005. The Colorado Historical Society agrees that non-public entity grant recipients should be required to conduct a competitive bidding process for larger grant projects, and this policy will appear in the next issue of the grant application handbook printed in January of 2005. Public entities are currently required to follow whatever process applies to them by law, and that policy should continue. Projects below the established level for competitive bid will be required to certify that a fair and open process was used, and to maintain records supporting that assertion.

Again, it should be noted that the statistic provided in the audit report was based on a pool of grants primarily to nonprofit organizations already identified by State Historical Fund staff as being problematic. The actual percentage of total grants in which the grant recipient failed to select their contractors using a competitive process is likely much lower than the statistic provided.

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## Enforcement of Grant Guidelines

In reviewing the Society's grant oversight process and examining grant files, we found several instances where requirements in the Fund's *Grant Program Guidelines* and *Grant Manual* were ambiguous or were not enforced, as described below.

**Interior Work.** The Fund's *Grant Guidelines* state that for private residential properties "grant funds should be restricted to exterior work." The *Guidelines* mention that other economic incentives (such as state tax credits) are available to private homeowners and that there is limited public benefit in restoring a private house. We reviewed a grant of \$195,000 for the acquisition and rehabilitation of a fire-damaged historic property. The property was converted to mixed-use (commercial and residential) as required by local zoning ordinances. The Society approved \$58,500 in grant funding for the interior rehabilitation of the commercial and residential space that does not appear to be allowed under the *Guidelines*. According to Society staff, internal project work that conforms with the U.S. Secretary of the Interior's Standards for the Treatment of Historic Properties can appropriately be funded by a grant. Therefore, the Society's practice of allowing grant funds to pay for some internal work for private residences appears to conflict with the written policy that grant funds for such projects should be restricted to exterior work. Given the limited amount of funding available for historic preservation grants, we believe the Board should consider the appropriateness of grant funding interior work on private homes and rental units. If the Board determines that under limited circumstances, such as in the case of severe interior damage, grant funding for interior work is appropriate, it should revise its *Guidelines* to clarify these circumstances to ensure that all applicants are aware of this opportunity.

**In-Kind Contributions.** The Fund's *Grant Guidelines* state that "in-kind contributions cannot be applied to the cash match requirement." However, for one project reviewed, we noted that the Society accepted an in-kind donation of \$13,800 as a cash match from the grantee. Society staff report that, in some instances, in-kind matches are allowed if the original intention of the grantee was to pay for the expense in cash, but later in the process the grantee received an in-kind donation to the project to cover the cash match requirement. The Society should either follow

its current guidelines related to in-kind donations or clarify the *Guidelines* to reflect those situations where grantees can use in-kind donations as their cash match.

**Reporting Expenditures.** The Fund's *Grant Manual* requires that grantees "report the amount paid under cash match and grant funds in the same ratio as estimated in the application." In other words, if a grantee has a 25 percent cash match, reported expenditures should be allocated 25 percent to the cash match and 75 percent to grant funds.

During our review we noted that grantees typically do not report cash match and grant funds according to the ratio in the application. Instead, they generally try to report expenditures in accordance with the approved budget. The budgets we reviewed typically allocate certain types of expenditures to cash match and other expenditures to grant funds, rather than use a consistent ratio for all expenditure types. For example, one grant budget we reviewed planned to use only grant funds for all exterior finishes while using only cash match funds for the interior electrical and plumbing work. Grant staff report that the Society would rather have grant funds be used for expenditures that are highly visible and of relatively more historic value, such as a historic cornice, than for items such as contractor travel. However, this policy is not communicated to grantees through the *Application Handbook*, *Program Guidelines*, or *Grant Manual*, and conflicts with the ratio requirement set forth in the *Grant Manual*. The Society should either make clear that grantees are required to report expenditures according to the contractually approved budget or enforce the ratio requirement set forth in the *Grant Manual*.

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## **Recommendation No. 8:**

The Colorado Historical Society should clarify and consistently enforce requirements in the *Grant Program Guidelines* and the *Grant Manual* by specifying:

- a. The circumstances in which grant funding of interior work is allowed.
- b. The circumstances in which in-kind donations will be accepted as cash match.
- c. How grantees should report cash match and grant fund expenditures.

## **Colorado Historical Society Response:**

- a. Agree. Implementation date: January 2005. The policy on interior work says that work on private residences "should" be restricted to exterior work. It clearly leaves the door open for funding interior work if an

application comes forward that makes an adequate case for that kind of support. This policy will be clarified in the next issue of the grant application handbook printed in January of 2005.

- b. Agree. Implementation date: End of Calendar Year 2004. This change has already been implemented. The contracts manual will be amended by the end of Calendar Year 2004 and our policy on this issue will be clarified in the next issue of the grant application handbook printed in January of 2005.
  - c. Agree. Implementation date: End of Calendar Year 2004. It is State Historical Fund's position that expenditure reporting should follow the specific budget as attached to the grant contract, not a strict split based on the bottom line ratio of grant to cash match. The contracts manual will be amended by the end of Calendar Year 2004 to reflect this clarification. We will also clarify this policy in the next issue of the grant application handbook printed in January of 2005.
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