

State of Colorado



John W. Hickenlooper
Governor

Kathy Nesbitt
Executive Director

Jennifer Okes
Deputy Executive Director

David J. McDermott
State Controller

DPA

**Department of Personnel
& Administration**

Office of the State Controller
633 17th Street, Suite 1500
Denver, Colorado 80202
(303) 866-6200
Fax (303) 866-4233
www.colorado.gov/dpa

December 13, 2011

John Hickenlooper, Governor
136 State Capitol
Denver, Colorado 80203

Dear Governor Hickenlooper:

Pursuant to C.R.S. 24-30-203.5(6a), I am forwarding the first recovery audit consultant's report (received on December 5th) documenting recovery audit activities from inception of the consultant's contract through November 30, 2011. The Office of the State Controller (OSC) entered into a contract with the Colorado firm, Balance Risk LLC, on August 22, 2011, following Legislative Audit Committee approval of audit exemptions on July 11, 2011.

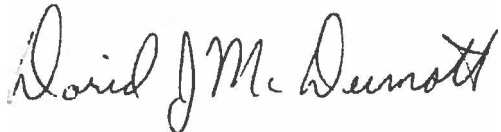
During the reporting period, OSC staff developed policies and procedures to administer the audit including an accounting model to track improper payment recoveries and ensure those recoveries are properly credited to the appropriate fund per C.R.S. 24-30-203.5(8). As discussed in the report, we arranged and held entrance conferences with key departments and technical staff regarding the recovery audit and the departments' contracting and disbursement policies and procedures. OSC staff and the Balance Risk team cooperatively developed templates and procedures to ensure audit communications, tracking, and reporting are complete and timely throughout the recovery audit.

Due to staff vacancies in the COFRS operations section of the Governor's Office of Information Technology, OSC staff developed a process to extract and transmit to Balance Risk five years of COFRS data to support audit of the three fiscal years specified in statute. The structure of the aging COFRS system and the limited tools available to extract approximately 66 million records presented challenges and resulted in delays in substantive audit work by Balanced Risk.

December 13, 2011

To date we have found the the Balance Risk team to be professional, competent, and genuinely interested in providing value to the State. We look forward to a successful review of the State's risk for improper payments. Please contact my office if you have questions regarding progress of the audit or Balance Risk's first report.

Sincerely yours,

A handwritten signature in cursive script that reads "David J. McDermott". The signature is written in black ink and is positioned above the printed name.

David J. McDermott, CPA
Colorado State Controller

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December 13, 2011

Dianne E. Ray, State Auditor,
Senator Lois Tochtrop, Chair Legislative Audit Committee,
Representative Cheri Gerou, Chair Joint Budget Committee
200 East 14th Avenue
Denver, Colorado 80203

Dear Auditor Ray, Senator Tochtrop, and Representative Gerou:

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Sincerely yours,



David J. McDermott, CPA
Colorado State Controller

Legislative Audit Committee Members

Senator Lois Tochtrop - Chair
Representative Cindy Acree - Vice-Chair
Representative Deb Gardner
Senator Lucia Guzman
Representative James Kerr
Senator Steve King
Representative Joe Miklosi
Senator Scott Renfroe

Joint Budget Committee Members

Representative Cheri Gerou, Chair
Senator Mary Hodge, Vice-Chair
Senator Pat Steadman
Senator Kent Lambert
Representative Jon Becker
Representative Claire Levy



December 5, 2011

Maria Pruett
Recovery Audit Administrator, Office of the State Controller
State of Colorado
633 17th Street, Suite 1500
Denver, CO 80202

State of Colorado Recovery and Contract Audit – Contract 12AAA 34968, Report #1

Dear Maria,

Please find below a narrative of audit progress for the recovery and contract compliance audit for the State of Colorado. Subsequent reports will follow the traditional format with claim issues and recoveries detected during audit fieldwork.

Summary

This first status report documents issues related to start up of work following execution of the contract on August 22, 2011. We participated in several kickoff meetings with executive directors and senior management for State of Colorado Departments with material spend during the scope period of the audit. Follow up meetings with department managers, controllers and other administrative staff allowed us to communicate our audit process and investigation techniques and initiate dialogue with State employees to document processes and discuss concerns or identify potential issues in obtaining contracts, invoices or other audit documentation. Data transfer was delayed due to lack of staffing resources, obstacles in actually pulling detail information from the COFRS system and constraints related to the close of Fiscal Year 2011 and financial reporting required by statute. We anticipate that data transfer will continue into 2012 as we identify essential information from tables and feeder systems into COFRS. Department of Transportation SAP information transfer began in November and likely will be completed in mid December.

Delays in delivering the detail accounts payable information impacted the start of statement letter, improper payment and contract compliance audit segments of work. Statement and improper payment review will commence in December and contract compliance audit fieldwork will begin in January or early February 2012 pending scheduling with vendors selected for review.

Overall, cooperation and assistance from State employees has been excellent. We have faced moderate resistance to our review causing delays to our start up. However, considering that this is the first significant statewide effort to perform a recovery and contract compliance audit, we believe the time and effort spent on communication and introductory meetings will prove beneficial once we begin fieldwork and produce claim issues for review.

Audit Kickoff Meetings

Audit Kickoff meetings were held with the following departments:

- Department Controllers' Roundtable – August 24
- Department of Transportation – September 13
- Department of Treasury – September 14
- Department of Public Safety – September 19
- Department of Corrections – September 21
- Department of Education – September 21
- Governor's Office of Information Technology – September 26
- Department of Health Care Policy and Finance – October 17

Follow up meetings were conducted in November with Department employees to inform them of the audit, nature of claim issues and supporting documentation requirements to build claims for presentation to vendors as well as conduct contract compliance audits.

- DOT Engineering and Business Managers
- DOC Controller and Staff
- DPA Central Services, Capitol Complex and Fleet Vehicles
- DPA Contracting and State Pricing Agreements
- DPA Payables and Warrant processing

Data Transfer

Discussions relative to data requirements for the COFRS accounting system started immediately after signing the contract. Balance Risk also initiated discussions relative to transfer of SAP data with Department of Transportation following our kickoff meeting with that department on September 13, 2011. COFRS data transfer was performed by a single individual in the Controller's Office- Reporting and Analysis Team, as the Office of Information Technology was not able to support the effort due to their current work load. The process for extracting the data was complicated by issues such as constraints on the number of records that could be pulled at one time, technical problems that required complex programming and exclusion of sensitive information such as HIPAA data that would not be relevant for the audit. Following completion of the accounting close and financial reporting requirements for Fiscal Year 2011, data transfer was initiated on October 11. The second transfer was delayed until October 24, and then regular transmission occurred through November 7. COFRS data from January 2007 through September 2012 has been completed for all departments except for the Department of Health Care Policy and Finance (HCPF). HCPF has a regular recurring audit for improper payments for medical goods and services that is being performed by another firm. HCPF is working with the analyst capturing data for this audit to ensure that there is no overlap on data transferred for review as well as excluding sensitive HIPAA information. Data transfer through current allows us to eliminate false positive issues and significantly increases the productivity of the audit and reduction of time spent by both State

employees and vendors reviewing issues that had already been resolved after the scope period end date. Initial SAP data transfer was initiated on November 18 and should be completed by December 9. We are in active discussions to acquire Site Manager Data from the Department of Transportation. This exercise is expected to be completed by December 16.

Data Transferred from COFRS:

- Vendor Master Table – 120 Thousand records
- Detail Transactions – 66 Million records
- Contract Tables – 61 Thousand records

Data Transferred from SAP:

- Vendor Master Table – 21 Thousand records
- Pricing and Payment Transfers – 170 Thousand records

Balance Risk is currently working through data issues from COFRS extraction parameters such as truncated vendor numbers due to sensitive information concerns. We are also in the process of determining whether any other essential information is required to execute the audit.

Feeder systems into COFRS will be evaluated to determine if additional information will be required to execute the audit. At this time we are not able to identify the specific feeder system or volume of information that will be requested. We are still compiling data received to date.

Delays in data acquisition have had a significant impact on audit scheduling and execution. Holiday seasons and end of the calendar year will delay initiation of the contract compliance phase of work due to issues with scheduling fieldwork review with vendors. We were planning on having at least two contract audits completed by December, but our first contract audit likely will not be completed until late January or early February of 2012. Delays are also expected for vendor response to statement solicitation requests. The statement solicitation letters will be sent out in December. With the current pace of data received, we anticipate that audit data will continue to be transferred through the first quarter of 2012. We are attempting to balance initiation of the audit work with productivity and maintaining a low impact on State resources.

Audit Fieldwork

Statement Solicitation – Balance Risk is currently identifying the vendor population for the statement solicitation letter. The letter was reviewed and approved by the Controller's office in November. It is expected that the first letters will be sent to vendors the week of December 5th.

Improper Payment Review – Balance Risk will prepare standard improper payment reports with existing COFRS data and will rerun certain reports when data transfer from the Department of Health Care Policy and Finance and the SAP data from the Department of Transportation is completed. Efforts will be

made to reduce any disruption to state resources to assist in document pull during sensitive periods. It is expected that this portion of work will be initiated in mid-December and continue throughout the audit.

COFRS does not require input of either an Invoice Number or Invoice Date to process a transaction for payment. This presents unique challenges for improper payment review and will diminish the value of data metrics (analysis of accounts payable processing activities) for this engagement.

Contract Compliance Audit – As noted in the Data Transfer section, the lead time required to schedule on site vendor audit work will push the first audits for this segment to either the end of January or beginning of February. Preliminary work will be completed while we are attempting to schedule vendor on site audits.

Telecommunications – The Abilita audit team (Balance Risk partner brought in to execute this specialty area of the audit) has initiated contact with the material spend telecommunication service providers and they are in the process of obtaining vendor data such as customer service records, contracts and amendments and billing records. Detailed comparisons with State of Colorado contracts and data should begin in December.

Administration

Audit report formats have been delivered to the Recovery Audit Administrator and are in the process of being reviewed to ensure all essential data elements for claims are being included. Statement letter templates were drafted, reviewed and approved for distribution to vendors. All Department Executive Directors received a memo from the State Controller outlining the recovery and contract audit. Internal reporting activities for claim preparation, review of claim issues and periodic audit reporting have been discussed with the following departments:

- Department of Personnel and Administration
- Department of Transportation
- Department of Corrections
- Department of Public Safety
- Department of Treasury
- Department of Education
- Governor's Office of Information Technology
- Department of Health Care Policy and Financing

As we identify our initial recovery audit claim issues, we will reach out to those Departments that have not had a formal introduction to the audit and review in detail our audit process and provide specific information for claim development, review and resolution.

Conclusion

While there have been delays in the start up for this recovery audit, the information and communication relative to the kickoff and follow up meetings has provided a forum to discuss potential areas of recovery opportunity, provide insight into current control processes and areas of internal audit, review and analysis of spending, and allowed State employees to express their concerns regarding the potential impact the audit may have on their workload and ability to support the audit. Balance Risk has emphasized the focus of the audit should address not only recoveries, but also identifying root cause issues for overpayments and communicate best practice opportunities for improvement.

We are looking forward to the escalation of work now that the groundwork for the engagement has been substantially completed.

Respectfully,

A handwritten signature in black ink, appearing to read "R. Serocki", written in a cursive style.

Robert J. Serocki
President, Balance Risk, LLC