

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

April 9, 2012

John Hickenlooper, Governor
136 State Capitol
Denver, Colorado 80203

Dear Governor Hickenlooper:

Pursuant to Section 24-30-203.5(6)(a), C.R.S., I am forwarding the recovery audit consultant's 2nd report documenting recovery audit activities from inception of the contract through March 20, 2012. The Office of the State Controller 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.

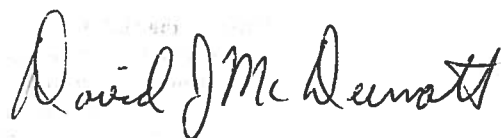
During the reporting period, the contractor worked with the State to obtain the transaction detail needed to identify improper payments. Transaction data was pulled from COFRS as well as the Department of Transportation's standalone SAP accounting system. The contractor is still in the process of compiling and verifying the data in preparation for conducting traditional data analytics to identify duplicate payments. Additionally, the contractor is conducting a statement review to identify vendors with outstanding credits due to the State. Finally, the contractor is also in the process of reviewing unclaimed warrants (checks) to determine whether any are related to improper payments.

While the contractor has made progress, it has been slowed by data challenges, particularly with COFRS, which has inherent data limitations due to the system's age.

April 9, 2012

To date we have found 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 report.

Sincerely yours,



David J. McDermott, CPA
Colorado State Controller

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

April 9, 2012

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

Dear Auditor Ray, Representative Acree, and Representative Gerou:

Pursuant to Section 24-30-203.5(6)(a), C.R.S., I am forwarding the recovery audit consultant's 2nd report documenting recovery audit activities from inception of the contract through March 20, 2012. The Office of the State Controller 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, the contractor worked with the State to obtain the transaction detail needed to identify improper payments. Transaction data was pulled from COFRS as well as the Department of Transportation's standalone SAP accounting system. The contractor is still in the process of compiling and verifying the data in preparation for conducting traditional data analytics to identify duplicate payments. Additionally, the contractor is conducting a statement review to identify vendors with outstanding credits due to the State. Finally, the contractor is also in the process of reviewing unclaimed warrants (checks) to determine whether any are related to improper payments.

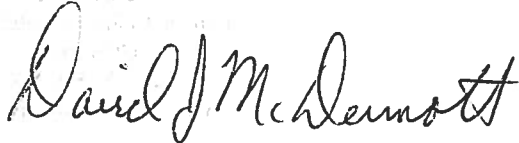
While the contractor has made progress, it has been slowed by data challenges, particularly with COFRS, which has inherent data limitations due to the system's age.

Dianne E. Ray,
Representative Cindy Acree, and
Representative Cheri Gerou

April 9, 2012

To date we have found 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 report.

Sincerely yours,



David J. McDermott, CPA
Colorado State Controller

Legislative Audit Committee Members

- Representative Cindy Acree, Chair
- Representative Angela Williams, Vice-Chair
- Senator Lucia Guzman
- Representative James Kerr
- Senator Steve King
- Representative Joe Miklosi
- Senator Scott Renfroe
- Senator Lois Tochtrop

Joint Budget Committee Members

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



March 20, 2012

Jennifer Henry, Manager Statewide Internal Audit
Acting 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 #2

Dear Jennifer,

Please find below a narrative of audit progress for the recovery and contract compliance audit for the State of Colorado. This report presents data issues and efforts required to begin substantive testing. We are pleased to report that duplicate and overpayment testing will be initiated in March 2012.

Summary

The second report summarizes the myriad issues we have encountered in starting up this recovery audit. While progress has been painfully slow from our perspective, we have adjusted our audit program by working in areas that are traditionally executed in later stages of work to show some progress.

Balance Risk has received and processed the Department of Transportation SAP data. Potential duplicate and overpayment analysis has begun for this agency and the audit team will be identifying and developing issues throughout the month of March 2012.

Our biggest obstacle to date has been dealing with the primary system for this audit- COFRS, the State financial reporting system. We have identified and addressed issues in the following areas:

- Confidentiality restrictions prohibited transfer of the vendor master data
- System configuration issues and filtered data
- Lack of complete data on initial transfer has led to follow up requests for information

We also have encountered issues relative to SAP data, specifically having to work around issues regarding specific data tables that are the foundation to the recovery audit process that were not able to be provided due to various issues with size and complexity of how Department of Transportation set up their use of the system.

Balance Risk has requested and received additional data and found work around solutions to the most significant issues encountered for COFRS and SAP data. A more detailed discussion is included in the **Data** section of this status report.

Balance Risk has initiated review of unclaimed property issues relative to improper payments and vendor refunds.

Initial statement requests from vendors have led to a much lower potential recovery rate compared to typical recovery audits. We temporarily suspended additional mailings until we had completed the data compilation for COFRS, and will resume this area of work in March 2012 when we are able to incorporate spend analysis more completely into the vendor selection process.

Balance Risk Telecommunication audit subcontractors, Abilita, are still in the process of gathering data for the telecommunications audit. This segment of work is also moving slowly, but we intend to present a small set of findings for review and presentation to vendors in March 2012.

For contract compliance audit, our initial review of funds spent with vendors created a short list of potential vendors for audit in the Department of Corrections and Department of Transportation. We learned later the vendors selected had already undergone internal contract review from either the department, internal audit or both groups. These contracts were determined to have low recovery potential and were not pursued. Balance Risk is currently analyzing the updated payment information to identify additional vendors with recovery audit potential.

Data

We continued to experience significant issues with obtaining and processing the COFRS data required to execute the audit. In the initial reporting period, the reasons for delays were:

- System constraints on extracting data from the system
- Experience in performing the extracts and ensuring sensitive data was excluded from the dataset
- Resource constraints for the one financial reporting analyst in the Controllers department assigned to provide the data for the audit to perform the data extraction while completing their regular assigned responsibilities

For this reporting period, we received support from COFRS OIT group. The first data analyst assigned to provide assistance got up to speed over a four week period, and then left for a job in the private sector. A second analyst was assigned that did not have a strong working knowledge of the archived data needed. After several additional weeks, the archived data was located and transmitted. However, we noted significant gaps (missing records) in the data. We are currently finalizing an inventory of missing transaction header information.

COFRS Data Challenges -The summary of data issues encountered to date:

- **COFRS vendor number was not provided.** The State Controller deemed that the vendor number was sensitive information (in some cases a social security number) and could not be provided as part of our data for this review. We spent approximately six weeks creating a separate vendor master file to use on the audit.
- **The COFRS system does not require input of invoice number or date to process an invoice.** These are two critical data elements in a traditional accounts payable audit review. Multiple invoices can and are regularly input for payment in a Payment Voucher. Lack of invoice number and date makes review for duplicate payments extremely difficult and challenging. The State Controller and Deputy Controller have been informed that lack of required invoice and date data elements, field validation controls and input controls provide a great risk exposure to undetected improper payments and fraud.
- **Data matching issues.** A significant number of records transferred for the audit do not match within batches, due to system configuration or extraction which specifically filtered confidential information. Balance Risk solution to this issue includes systematic formatting and manually segregating the data to provide a usable set of information to execute the duplicate payment review.
- **Data is incomplete.** We have found certain archived files that contain payment summary information were not transferred. We have provided a specific list for those items, and data analysts are looking for this information. The way payment vouchers are processed precludes our ability to perform data analytics relative to invoice payment processing for traditional clients. Where possible, Balance Risk will provide payment analytics and reports for review.

These issues will impact the full breadth of testing and data analytics that are typically part of every recovery audit exercise.

The difficulty in executing the audit lies solely on the use of an aging and antiquated COFRS system. Modern accounting systems not only provide a standard methodology for control over procure to pay activities, but also provide a platform to perform data analytics and reduce exposure to risk. With COFRS, traditional data analytics are not possible which contributes to an increased exposure to risk.

SAP Progress - On a more positive note, SAP data received from the Department of Transportation has been compiled and we have initiated improper payment testing. We estimate the audit team should be completed with improper payment review for the Department of Transportation in April. Balance Risk intends to start contract audit work in April and could continue until completion of the main recovery audit project if there are recovery audit opportunities worthy of review. We would like to note that while we have made significant progress, there have been significant workarounds for SAP data also.

Balance Risk received OIT support in acquiring SAP data. We also gained insight into how the software was set up and is being used by the department. Data fields and input controls allow data analytics and provide an improved environment to manage risk.

Audit Fieldwork

Statement Solicitation – Balance Risk sent approximately 1,300 letters to vendors in December 2011 and January 2012. Responses received from vendors yielded a much significantly lower incident of potential claim issues and open invoices. We suspended mailing additional letters until we finished compiling the accounts payable data. We will resume mailing letters in March 2012 and will update progress in the next report.

Improper Payment Review – Balance Risk is preparing improper payment analysis for SAP. We anticipate beginning improper payment analysis for COFRS data by the end of March 2012. Due to data acquisition issues, we fully expect this portion of work will continue through September 2012. As part of procure to pay review related to improper payments, Balance Risk initiated an unclaimed property review. This area traditionally is executed in the later stages of a recovery audit.

Contract Compliance Audit – We anticipate scheduling audits beginning in April and having work ongoing through the end of the audit.

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. Data acquisition is on-going; however a small sample of potential items is currently being developed. Test exception areas will be presented for review in March 2012.

Administration

Audit claim report formats have been finalized to ensure all essential data elements for claims and recoveries are gathered as part of the claim development and collection process. A few claims issues in Statements and Unclaimed Property have been developed and presented for review within their respective agencies.

Balance Risk is looking forward to quickly moving forward on improper payment review for SAP and COFRS data.

Respectfully,



Robert J. Serocki
President, Balance Risk, LLC