

COLORADO OFFICE OF THE STATE AUDITOR



COLORADO HEALTH INSURANCE BENEFITS EXCHANGE: CONNECT FOR HEALTH COLORADO



OCTOBER 2014

LIMITED PERFORMANCE AUDIT

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October 27, 2014

DIANNE E. RAY, CPA

STATE AUDITOR

Members of the Legislative Audit Committee:

This report contains the results of a limited performance audit of the Colorado Health Insurance Benefits Exchange: Connect for Health Colorado. The audit was conducted pursuant to Section 10-22-105(4)(b), C.R.S., which authorizes an audit of the monies received by the exchange. The report presents our findings, conclusions, and recommendations, and the responses of Connect for Health Colorado.

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REPORT HIGHLIGHTS



COLORADO HEALTH INSURANCE BENEFITS EXCHANGE: CONNECT FOR HEALTH COLORADO LIMITED PERFORMANCE AUDIT
OCTOBER 2014

CONCERN

We found that Connect for Health Colorado has not sufficiently ensured that public funds have been spent in accordance with federal requirements, that staff follow internal financial and accounting policies and procedures consistently, and that financial controls adequately safeguard its resources as its last federal grant enters its final stage and the organization moves to become self-sustaining.

KEY FACTS AND FINDINGS

- We identified problems with 35 out of the 92 vendor and grantee payments and contracts that we sampled (38 percent), resulting, in part, in \$412,137 in questioned costs due to noncompliance with federal or contract requirements.
- Connect for Health paid \$55,975 to vendors and \$432,809 to grantees that were unallowable or unreasonable uses of federal funds. Connect for Health also paid some sampled vendors and grantees \$185,866 without support for the payment amounts or services provided.
- Connect for Health made high-dollar payments to some vendors without fully executed contracts or without the Board's approval, as required by internal procedures.
- Connect for Health did not consistently or accurately record all transactions in its general ledger, or have sufficient controls over user access to its accounting system.
- Connect for Health did not take steps to contain administrative costs in some areas. For example, during Fiscal Years 2013 and 2014, it paid two contractors over \$2.2 million to negotiate and monitor information technology contracts.

BACKGROUND

- Connect for Health Colorado was created in 2011 pursuant to the federal Affordable Care Act that requires all states to either have a state-run health exchange or use the federal health exchange.
- Connect for Health administers Colorado's health exchange that consumers can use to purchase private health insurance.
- Connect for Health was awarded \$177.7 million in federal grants to implement Colorado's health exchange. As of September 2014, it had spent \$136.5 million of these federal grant funds.
- Connect for Health is overseen by a 12-member Board of Directors appointed by State government, and is administered on a day-to-day basis by an Executive Director/CEO.

KEY RECOMMENDATIONS

Connect for Health Colorado should:

- Establish comprehensive procurement and payment policies and procedures, document purchases prior to payment, monitor payments to contractors, and obtain Board approval for contracts in line with federal requirements.
- Establish policies for administering its grant program, pay grantees accurately and in compliance with federal requirements and grant contracts, and evaluate whether to continue making advance payments to grantees.
- Improve internal controls over accounting and financial transactions to ensure compliance with applicable laws, regulations, and internal requirements.

Connect for Health agreed with all of the recommendations.



RECOMMENDATION LOCATOR

ORGANIZATION ADDRESSED: CONNECT FOR HEALTH COLORADO

REC. NO.	PAGE NO.	RECOMMENDATION SUMMARY	ORGANIZATION'S RESPONSE	IMPLEMENTATION DATE
1	37	Improve controls over the purchase of goods and services from vendors by (A) establishing written policies requiring documentation of goods and services, (B) establishing processes to ensure staff understand federal compliance and review transactions before they are paid, (C) ensuring there is an adequate number of supervisors and staff to review financial information for accuracy and verify goods and services are received, (D) establishing a risk-based process to expedite low-risk purchases, (E) implementing ongoing monitoring to ensure policies and procedures operate as intended, (F) training Board members, management, and staff on the new policies and procedures, and (G) recovering payments for unallowable costs and errors, as appropriate.	AGREE	A FEBRUARY 2015 B MARCH 2015 C JUNE 2015 D DECEMBER 2014 E MARCH 2015 F JUNE 2015 G MARCH 2015

ORGANIZATION ADDRESSED: CONNECT FOR HEALTH COLORADO

REC. NO.	PAGE NO.	RECOMMENDATION SUMMARY	ORGANIZATION'S RESPONSE	IMPLEMENTATION DATE
2	57	Improve controls over payments to contractors and contract administration by (A) establishing a comprehensive written procurement policy or procedure that specifies the Board's contract approval responsibilities, (B) establishing procedures to accurately track contracts and monitor vendor payments, (C) utilizing contract templates to ensure contracts include all federally-required provisions, authorized signatures, statements of work, and payment terms, (D) establishing procedures to ensure the Board receives information on contracts exceeding the Board approval threshold and approvals are documented, and (E) training Board members and staff on the new policies and procedures.	AGREE	A JANUARY 2015 B MARCH 2015 C JANUARY 2015 D MARCH 2015 E JUNE 2015
3	74	Ensure payments to grantees are reasonable, accurate, and allowable by (A) establishing a comprehensive policy to administer the grant program and paying grantees in compliance with federal regulations, contract terms, and supporting documentation, (B) establishing procedures to ensure timely payments to grantees, adequate staffing to review grantee payment requests and conduct supervisory review, and accurate recording of transactions, (C) evaluating the practice of paying grantees in advance, and (D) investigating and recovering, as appropriate, overpayments resulting from noncompliance and errors.	AGREE	A MARCH 2015 B DECEMBER 2014 C MARCH 2015 D MARCH 2015
4	90	Improve fiscal management by (A) establishing written financial policies and controls that ensure proper accounting, recording of financial transactions and checks, and compliance with applicable laws, regulations, and internal requirements, (B) ensuring an appropriate number of staff and supervisors are assigned to accounting and have appropriate system access and separation of duties, (C) conducting periodic risk-based quality control reviews for compliance, and (D) training Board members and staff on the new policies and procedures.	AGREE	A MARCH 2015 B JUNE 2015 C APRIL 2015 D JUNE 2015

CHAPTER 1

OVERVIEW OF COLORADO'S HEALTH INSURANCE BENEFITS EXCHANGE

In 2010, the federal Patient Protection and Affordable Care Act (Affordable Care Act, or Act) was enacted to reform the health care system in the United States. A key requirement of the Affordable Care Act is that all Americans obtain public or private health insurance or pay a penalty (42 U.S.C. 18091, Section 1501 and 26 U.S.C. 5000A). To accomplish this requirement, the Act authorizes federal funding: (1) to establish health insurance exchanges, (2) to allow states to expand Medicaid eligibility, and (3) to provide federal tax credits to individuals who are ineligible for Medicaid but have incomes between 100 and 400 percent of federal poverty guidelines.

A health insurance exchange is a competitive, organized marketplace that helps consumers and small businesses purchase health insurance by comparing available health plan options based on price and benefits.

The Centers for Medicare and Medicaid (CMS) within the federal Department of Health and Human Services (HHS) is responsible for administering the Affordable Care Act and authorizing funding for the implementation of health insurance exchanges. CMS guidance specifies that exchanges are meant to create efficient and competitive health insurance markets by increasing transparency of health plan prices and quality, and reducing the overall costs of health plans by spreading risk across a larger pool of consumers.

TYPES OF EXCHANGES

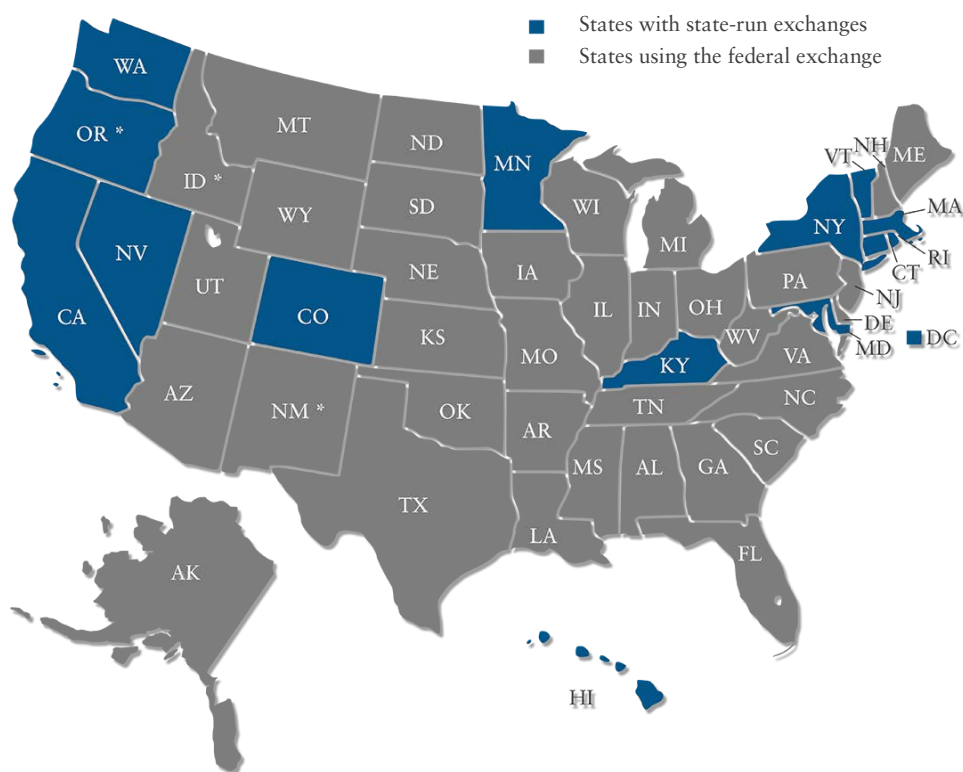
Federal regulations [45 CFR 155.105(f)] require each state to either implement its own state-run health insurance exchange or use the federal exchange, as described below:

- **STATE-BASED EXCHANGE OPERATED BY THE INDIVIDUAL STATE.** This type of exchange is created and operated by a state as either a governmental agency or nonprofit organization outside of state government. CMS issues federal grants to states to establish an exchange and oversees the state-based exchanges during their development and implementation. Each state exchange administers a state-based website to enroll its residents in health insurance plans approved by the state, and provides consumer assistance to those interested in enrolling in a health plan. The Affordable Care Act also gives states the option to offer the Small Business Health Options Program (SHOP) to help small businesses find and provide affordable health care coverage for their employees. In Colorado, businesses must employ between two and 50 employees to participate in SHOP. As of October 2014, there were 14 states, including Colorado, as well as the District of Columbia that had a state-based health insurance exchange.

- FEDERALLY-FACILITATED EXCHANGE OPERATED BY HHS.** The Affordable Care Act (42 U.S.C. 18041, Section 1321) requires each state to utilize the federally-facilitated exchange if the state does not establish its own exchange. As of October 2014, a total of 36 states used the federally-facilitated exchange. Seven of these 36 states, have state-federal partnerships in which the state and federal government jointly administer exchange activities. For example, the state manages consumer assistance and certifies health plans in the state but state residents use the federal health exchange's website to enroll in a state-approved health plan.

Exhibit 1.1 shows the 14 states and one district with a state-based health insurance exchange and the 36 states using the federal exchange.

**EXHIBIT 1.1. HEALTH EXCHANGES IN THE UNITED STATES
AS OF OCTOBER 2014**



SOURCE: Office of the State Auditor's summary of health insurance exchanges.

* In November 2014, Idaho and New Mexico will transition from utilizing the federal exchange to their own state-run exchanges. Oregon will transition from operating its own exchange to utilizing the federal exchange.

COLORADO'S HEALTH EXCHANGE

In May 2011, the General Assembly passed Senate Bill 11-200 creating the Colorado Health Insurance Benefits Exchange as a “non-profit, unincorporated public entity” that is an “instrumentality of the state” but not a state agency (Section 10-22-104, C.R.S.). The legislative declaration states that the Colorado Health Insurance Benefits Exchange is intended to, “increase access, affordability, and choice for individuals and small employers purchasing health insurance in Colorado” (Section 10-22-102, C.R.S.). The primary purpose of Colorado’s exchange, renamed Connect for Health Colorado (Connect for Health, or exchange), is to act as a marketplace for individuals and small business employees to purchase health insurance plans. Connect for Health began receiving public funds to operate in February 2012.

Overall, federal regulations (45 CFR 155) require states that operate their own health insurance exchange to perform the following duties:

- Provide a toll-free call center, up-to-date website, and streamlined application system for enrolling consumers in health plans [45 CFR 155.205 and 155.405(a)]
- Determine whether consumers are eligible for a federal tax credit to assist with the costs of the health plan premiums, and provide an appeals process related to this eligibility determination [45 CFR 155.302(c) and 155.505]
- Provide free consumer assistance, including providing consumers information on health plans and eligibility in the state; provide referrals to assistance for consumers with complaints or questions; conduct outreach activities to educate consumers about the exchange and insurance affordability programs; and provide in-person assistance to help consumers enroll in health plans [45 CFR 155.205(d) and 155.210]

- Certify health plans for use in the state to ensure the plans provide coverage for certain health services, such as preventative and wellness services, emergency care, hospitalization, maternity and newborn care, mental health and substance use treatment, and prescriptions [45 CFR 155.1010(a) and 156.110].

Connect for Health carries out each of the above federally-required responsibilities for the State, except certifying health plans, which is performed by Colorado's Division of Insurance within the Department of Regulatory Agencies. The key services that Connect for Health provides Colorado include:

- **PROVIDING A MARKETPLACE FOR PURCHASING HEALTH PLANS.** Connect for Health operates a website through which consumers and employees of small businesses may compare health insurance plans and enroll in a plan. Consumers who have difficulty using the Connect for Health website or do not wish to enroll using the website may enroll using its toll-free customer service telephone number, or through state-licensed insurance agents and brokers certified through training contracted by Connect for Health. According to Connect for Health, its website had about 3 million unique visits between October 2013 and August 2014.
- **VERIFYING ELIGIBILITY FOR ENROLLMENT IN PRIVATE HEALTH PLANS.** According to Connect for Health, it checks the eligibility of consumers who would like to enroll in a private health plan that is sold through its website. Connect for Health must verify that each consumer is a United States citizen, resides in Colorado, and is not enrolled in or eligible for a public health plan, such as Medicaid, or an employer-sponsored health plan. According to federal regulations [45 CFR 155.320], an exchange may not enroll a consumer in a private health plan if the consumer is eligible for a public or employer-sponsored plan. Connect for Health management stated that it does not report on the total number of eligibility checks that it performs.

Federal regulations [45 CFR 155.410(2)(b)] required the federal exchange and all state exchanges to begin accepting enrollments in

health plans from October 2013 to March 2014 for plans covering Calendar Year 2014. Connect for Health reported that about 146,000 Coloradans enrolled in a health plan as of August 31, 2014.

- **CONDUCTING ELIGIBILITY DETERMINATIONS FOR FEDERAL PREMIUM TAX CREDITS.** According to Connect for Health, it determines whether consumers are eligible for a federal tax credit or cost-sharing reductions, which are financial assistance with health plan premiums. In Colorado, a consumer is eligible for this financial assistance if his or her income is between 133 percent and 400 percent of the federal poverty level, which is an annual income of \$11,670 for Calendar Year 2014. According to Connect for Health, the organization had determined that about 84,800 consumers were eligible for financial assistance through the premium tax credit or cost-sharing reductions as of August 31, 2014.
- **PROVIDING CONSUMER ASSISTANCE.** According to Connect for Health, it provides information to consumers on health plans, insurance affordability programs, and insurance eligibility requirements; assists consumers with questions and complaints; and educates consumers about Connect for Health’s services and health insurance options. Connect for Health contracts with a vendor to operate two customer assistance call centers—one in Colorado Springs, Colorado, and one in Tucson, Arizona—that handle inbound and outbound telephone calls.

Connect for Health also issues grants to organizations to provide in-person assistance to help consumers enroll in health plans. In July 2013, Connect for Health awarded \$12 million in federally-funded grants to 46 non-profit and governmental entities. In addition, in 2013 Connect for Health awarded \$2 million in privately-funded grants for in-person assistance using funds it received from the Colorado Health Foundation. According to Connect for Health, its grantees provided in-person assistance to about 8,700 consumers as of August 31, 2014.

ORGANIZATIONAL STRUCTURE

Connect for Health is administered by an Executive Director who is responsible for its daily management [Section 10-22-106, C.R.S.]. As of September 2014, Connect for Health had about 43 staff and management who assisted with administering and overseeing its operations from a main office in Denver, Colorado. Connect for Health also contracts with consultants to provide administrative assistance in areas such as accounting, human resources, information technology, and contract management. Connect for Health's call center contractor employs about 75 staff in the Colorado Springs center and about 15 staff in the Arizona center year-round, but increased staffing to 225 in Colorado Springs and 85 in Arizona during the open enrollment period October 2013 through March 2014.

BOARD OF DIRECTORS

Federal regulations [45 CFR 155.110(c)] require that a board of directors provide oversight and governance for each state-based exchange. In Colorado, Connect for Health's Board of Directors (Board) is comprised of nine voting and three nonvoting members. According to statute (Section 10-22-105, C.R.S.), the Governor appoints five voting members with no more than three from the same political party. Colorado's President of the Senate, Speaker of the House, and Senate and House Minority Leaders each appoint one voting member to the Board [Section 10-22-105(1)(a), C.R.S.]. According to statute [Section 10-22-105(1)(b), C.R.S.], the voting Board members must possess specific knowledge and skills in the areas of health insurance and benefits administration, health care finance and service provision, information technology, and small business development. Further, statute [Section 10-22-105(1)(c), C.R.S.], requires the Executive Director of the Department of Health Care Policy and Financing, the Commissioner of Insurance, and the Director of the Governor's Office of Economic Development and International Trade to serve as the Board's three nonvoting members.

Federal regulations [45 CFR 155.110(d)] allow states flexibility in determining their board’s responsibilities but require each board to have guiding governance principles. According to statute (Section 10-22-106, C.R.S.), the Board’s key duties and responsibilities include:

- Appointing an executive director, creating the exchange’s initial operational and financial plans, and reporting the planning and creation of the exchange to the Governor and General Assembly.
- Applying for the federal grants in order to establish the exchange.
- Examining model internet portals used for health plan enrollment and determining premium tax credit eligibility.
- Considering the affordability and cost of insurance plans in the context of quality care and increased access to purchasing health insurance.
- Considering whether the exchange should sell ancillary products. Statute does not define “ancillary products.” Connect for Health has considered selling health plan ancillary products such as vision insurance.
- Providing the organization technical and advisory assistance.

The Board has divided oversight of Connect for Health into the following four committees: executive, finance, operations, and policy and regulations. According to Connect for Health, the Board’s committees provide oversight of Connect for Health’s management, finances, and operations, and monitors and responds to policies and regulations that impact Connect for Health.

LEGISLATIVE COMMITTEE OVERSIGHT

Statute (Section 10-22-107, C.R.S.) created the Legislative Health Benefit Exchange Implementation Review Committee (Committee) in 2011 for the purposes of, “guiding implementation of an exchange in

Colorado, making recommendations to the General Assembly, and ensuring that the best interests of Coloradans are protected and furthered....” The Committee is comprised of 10 members appointed by the General Assembly’s legislative leadership. The President of the Senate and Speaker of the House each appoint three members, and the Senate and House Minority Leaders each appoint two members. Statute (Section 10-22-107, C.R.S.) requires the Committee to meet at least twice each year to review the Board’s federal grant applications and Connect for Health’s operational and financial plans.

REVENUES AND EXPENDITURES

The Affordable Care Act (42 U.S.C. 18031, Section 1311) authorizes federal grants to states establishing their own exchanges. CMS awards the grants and oversees states’ progress with exchange implementation. CMS provides states Level One Establishment Grants (Level One Grants) for costs associated with implementing state exchanges. If CMS determines the state has made sufficient progress in developing a state-based exchange using the Level One Grants, the state is eligible to receive a Level Two Establishment Grant (Level Two Grant). A Level Two Grant must be used to fund additional exchange development and implementation activities and enroll consumers in health plans.

Since its creation, Connect for Health has applied for and received two Level One Grants and one Level Two Grant, which have primarily funded its operations. When Connect for Health applied for these federal grants, it submitted grant award applications to CMS, which included proposed budgets and operational plans. CMS approved federal grant awards for Connect for Health totaling \$177.7 million, as shown in Exhibit 1.2.

EXHIBIT 1.2. FEDERAL GRANT AWARDS RECEIVED BY CONNECT FOR HEALTH GRANT PERIODS THROUGH DECEMBER 2014			
GRANT	GRANT PERIOD	PURPOSE	AMOUNT ¹
Level One Grant	February 2012 to April 2013	Information technology (IT) and consulting expenses to establish the exchange	\$ 17,951,000
Level One Grant	September 2012 to January 2014	IT and consulting expenses to continue implementation	\$ 43,486,747
Level Two Grant	July 2013 to December 2014	Continuing implementation expenses, including costs for a call center, the in-person assistance grant program, and operations through 2014	\$116,245,677
TOTAL			\$177,683,424

SOURCE: Office of the State Auditor's analysis of Connect for Health's grant award documents.
¹ Connect for Health receives federal funding primarily on a reimbursement basis and the amounts in this table reflect each grant award and not the amount expended under the awards.

Connect for Health's fiscal year is July 1 through June 30, the same as the State's fiscal year. As shown in Exhibit 1.3, Connect for Health received most of its federal grant funds, about \$130 million, during Fiscal Years 2013 and 2014. As of September 2014, the end of the first quarter of State Fiscal Year 2015, Connect for Health reported that it had spent about \$136.5 million (77 percent) of its federal grant awards.

Statute (Section 10-22-108, C.R.S.) specifies that state general funds shall not be used to support Colorado's health exchange, and therefore, Connect for Health has not been appropriated general funds. In addition to its federal funding, Connect for Health received about \$24.2 million from non-federal sources during Fiscal Years 2013 and 2014, as shown in Exhibit 1.3. These funds primarily included revenues reallocated from CoverColorado, the State's insurance program for individuals with pre-existing medical conditions, which has been discontinued; tax credit donations from insurance carriers; a private grant from the Colorado Health Foundation for in-person consumer assistance costs; and income earned from administrative fees that Connect for Health began collecting from insurance carriers and small businesses during Fiscal

Year 2014. For the administrative fees, Connect for Health collects 1.4 percent of the cost of premiums for each health plan sold through the exchange from all insurance carriers and for processing premium payments from small business employers whose employees enroll in health plans through the exchange.

During Fiscal Years 2013 and 2014, Connect for Health's expenditures totaled about \$149.6 million, of which capitalized assets, customer service, and information technology expenses accounted for \$119.7 million (80 percent).

Exhibit 1.3 shows Connect for Health's revenues and expenditures for Fiscal Years 2013 and 2014, as reported on the organization's financial statement of activities.

**EXHIBIT 1.3. CONNECT FOR HEALTH
REVENUES AND EXPENDITURES (IN MILLIONS)
FISCAL YEARS 2013 AND 2014**

	2013	2014
REVENUES		
Federal grants	\$ 43.9	\$ 86.1
Transfers from CoverColorado ¹	–	15.0
Tax credit donations	–	5.0
Administrative fees	–	2.1
Colorado Health Foundation grant	–	2.0
Other revenues ²	0.1	0.03
TOTAL REVENUES³	\$ 44.0	\$ 110.2
EXPENDITURES		
Capitalized assets	\$ 17.6	\$ 31.6
Customer service ⁴	1.7	29.1
Technology and IT consulting ⁵	18.0	21.7
Marketing and outreach	2.1	8.8
Depreciation	1.2	4.8
Employee salaries and benefits	2.1	3.9
Operations consulting and training	1.4	3.8
Other general and administrative ⁶	0.4	1.4
TOTAL EXPENDITURES³	\$ 44.5	\$ 105.1

SOURCE: Office of the State Auditor's analysis of Connect for Health's audited statement of activities for Fiscal Year 2013 and unaudited statement of activities for Fiscal Year 2014.

¹ Includes monies transferred from the unclaimed property fund.

² Includes investment income and contributions.

³ According to Connect for Health, in Fiscal Year 2013, expenditures exceeded revenues because of capitalized assets that were cumulative from Fiscal Year 2012 to Fiscal Year 2013.

⁴ Includes expenses for the Colorado Springs call center.

⁵ Includes expenses for the development of the exchange website and software licenses.

⁶ Includes expenses for rent, meetings, printing, supplies, subscriptions and dues, insurance, and travel.

FUTURE FUNDING AND SUSTAINABILITY

According to the Affordable Care Act [42 USC 18031, Section 1311(d)(5)(A)], beginning January 1, 2015 all state-based health exchanges, including Connect for Health, must be self-sustaining without federal grant funding for operations. However, Connect for

Health has requested that CMS provide it an extension to spend its existing federal grant awards through June 2015; Connect for Health is awaiting CMS's decision as of October 2014.

According to Connect for Health, it projects that its future revenues will primarily come from the following sources:

- **ADMINISTRATIVE AND SPECIAL FEES PAID BY INSURANCE CARRIERS AND SMALL BUSINESSES.** The Affordable Care Act [42 USC 18031, Section 1311(d)(5)(A)] allows state-based exchanges, including Connect for Health, to charge an administrative fee for each health plan purchased through the exchange each month. The Board approved for Connect for Health to continue charging insurance carriers the 1.4 percent administrative fee on the cost of premiums for each health plan sold through the exchange through Calendar Year 2015.

In addition, statute [Section 10-22-109(2)(a), C.R.S.] allows the exchange to assess insurance carriers a special fee of up to \$1.80 per individual insured by a health plan in Colorado per month, through December 2016. In June 2014, the Board approved a special fee of \$1.25 per individual insured per month to be assessed to carriers starting in Calendar Year 2015.

- **PRIVATE FUNDING.** This includes continued grant funding from the Colorado Health Foundation to operate in-person assistance programs in 2015.
- **COVERCOLORADO FUNDS.** Any funds remaining after CoverColorado ends operations in early 2015 will be reallocated to Connect for Health.
- **INCOME FROM THE SALE OF ANCILLARY PRODUCTS.** As of April 2014, Connect for Health had identified vision insurance as a potential ancillary product that it may sell to compliment the health plans sold through the exchange.

RELEVANT FINANCIAL SYSTEMS

Connect for Health used Quickbooks for its bookkeeping and financial reporting from the beginning of its operations in February 2012 until June 2013. Beginning in July 2013, the Exchange began using a new accounting system called Intacct.

AUDIT PURPOSE, SCOPE, AND METHODOLOGY

We conducted this performance audit pursuant to Section 10-22-105(4)(b), C.R.S., which authorizes an audit of the monies received by the Board for the exchange. The performance audit was limited to reviewing the funds that Connect for Health has received and its financial activities and management of those funds, including its compliance with applicable laws and regulations and internal financial controls over the use of those funds to ensure they are used efficiently, effectively, and in the best interest of Coloradans.

Because of our limited statutory authority to audit Connect for Health, we did not perform audit work related to any of its responsibilities or operations that were not related to its financial activities and management. For example, we did not audit the effectiveness of the exchange website; processes for determining consumers' eligibility to enroll in health plans and receive premium tax credits; marketing or outreach activities; the effectiveness of the in-person assistance grant program; fee-setting methods; or Connect for Health's revenue and financial sustainability projections.

Audit work was performed from January 2014 through October 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence

obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit objectives were to assess whether Connect for Health has sufficient financial systems, policies, and controls for: (1) administering the public funds it receives and procuring goods and services in compliance with applicable laws, regulations, federal grant awards, and organizational policies and procedures; and (2) ensuring payments to its grantees comply with federal laws and regulations, grant contracts, and organizational procedures.

To complete our objectives, we conducted the following audit work:

- Analyzed the accuracy and completeness of Connect for Health's electronic general ledger accounting and financial data for Fiscal Years 2012, 2013, and 2014, through May 2014. This included surveying financial management regarding the controls over its new Intacct accounting system.
- Reviewed the results of Connect for Health's Fiscal Year 2012 Single Audit Report and Management Letter, and Fiscal Year 2013 Single Audit Report.
- Reviewed the audited financial statements from Fiscal Years 2012 and 2013, the unaudited Statements of Activities and Income Statements for Fiscal Year 2014, and Connect for Health's 2012 and 2013 Annual Reports.
- Assessed Connect for Health's financial staffing, accounting organizational structure, and financial reporting matrix.
- Reviewed the federal grant award-related letters, grant award provisions, and grant-related guidance that CMS provided Connect for Health.
- Analyzed Connect for Health's internal tracking and documentation for each of its contracted vendors and in-person assistance grantees.

- Conducted interviews with Connect for Health’s management, financial and accounting staff, a sample of six Board members (voting and non-voting), and staff from the HHS Office of the Inspector General (OIG).
- Reviewed applicable federal laws, regulations and requirements, and state statutes.
- Reviewed and evaluated Connect for Health’s written policies and procedures including its financial procedures; procurement policies; grant accountant policies and procedures; fraud, waste, and abuse policies; and travel reimbursement guidelines for contractors.

In addition, we conducted reviews of the following sampled Connect for Health financial transactions:

- A judgmental sample of 66 payments to vendors totaling about \$9.71 million that were recorded in Connect for Health’s general ledger in Fiscal Years 2013 and 2014. We selected the sample to ensure sufficient coverage of payments to different vendors, different types of expenses, high and low dollar payments, and payments near approval thresholds. For each payment in our sample, we reviewed Connect for Health’s electronic general ledger data and hard copy documentation, such as invoices, receipts, cancelled checks, vendor contracts, Board minutes, and email correspondence between vendors and Connect for Health management and staff. We also reviewed the contracts that Connect for Health had on file for the sampled vendors.
- A judgmental sample of 26 payments totaling \$567,700 to 10 of Connect for Health’s in-person assistance grantees, which were recorded in Fiscal Year 2014. We selected the sample to ensure sufficient coverage of payments to different grantees throughout the state. For each sampled grantee payment, we reviewed Connect for Health’s electronic general ledger data and hard copy documentation, such as invoices, receipts, cancelled checks, bank account statements, and check reconciliation documentation, Board minutes, and email correspondence between grantees and Connect for Health

management and staff. We also reviewed the grant contracts and grant budgets for the sampled grantees.

We designed our samples to help provide sufficient and appropriate evidence for the purpose of evaluating Connect for Health's internal controls over the monies it receives and compliance with federal laws and regulations. When samples were chosen, the results of our testing were not intended to be projected to the entire population. Rather, the samples were selected to provide sufficient coverage of those areas that were significant to the objectives of this audit.

We planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Generally accepted auditing standards in the United States define three levels of internal control weaknesses:

- A **MATERIAL WEAKNESS** is the most serious internal control weakness. A material weakness is a significant deficiency, or combination of significant deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a compliance requirement of a federal program will not be prevented by the organization, or detected and corrected, on a timely basis. None of the recommendations in this report are classified as material weaknesses.
- A **SIGNIFICANT DEFICIENCY** is a moderate internal control weakness. A significant deficiency is a control deficiency, or combination of deficiencies, that adversely affects the organization's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of federal compliance requirement will not be prevented or detected by the organization. This type of weakness merits attention by those charged with governance. The four recommendations in this report are classified as significant deficiencies.
- A **DEFICIENCY IN INTERNAL CONTROL** exists when the design or operation of a control does not allow management or employees, in

the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.

Our conclusions on the effectiveness of internal controls, specific details about the audit work supporting our findings and recommendations, and Connect for Health’s responses to the recommendations are described in CHAPTER 2 of this report. We did not audit the accuracy of Connect for Health’s responses.

CHAPTER 2

ADMINISTRATION AND USE OF PUBLIC FUNDS

Connect for Health Colorado (Connect for Health, or exchange) is a unique organization that provides a new federally-required public service to Coloradans. It is a State-created nonprofit overseen by a State-appointed Board of Directors (Board) and has been funded almost exclusively with public monies, but it is not a state agency. It is also expected to be self-sustaining in 2015, creating a unique operating framework. Connect for Health began implementing the State's health insurance marketplace in February 2012 and serving the public in October 2013. As the provider of a public service and a recipient of more than \$136 million in federal funds since 2012, Connect for Health must ensure that it uses public funds and administers the organization in a fiscally responsible manner, in the best interests of Colorado.

We reviewed Connect for Health’s practices for administering and using the public monies it has received. Overall, we found that Connect for Health has not taken sufficient steps to ensure that public funds have been spent in accordance with federal requirements, that staff follow internal financial and accounting policies and procedures, and that financial controls adequately safeguard its resources as its federal grant ends and it moves to become self-sustaining. The audit identified deficiencies in Connect for Health’s practices related to procurement and paying vendors, contract execution and administration, paying grantees, and general accounting and financial management. We discuss these issues and our recommendations for improvement in the remainder of this report.

PAYMENTS TO VENDORS

During Fiscal Years 2012 through 2014, Connect for Health has relied heavily on vendors to help implement and operate Colorado’s health exchange. Connect for Health primarily used its federal grant funds to hire vendors to provide a broad range of goods and services including information technology, marketing, advertising, legal and accounting services, human resources consulting, and training for Connect for Health staff, customer service providers, and insurance brokers.

Based on our analysis of the general ledger, we estimated that Connect for Health recorded payments totaling \$117.2 million in federal funds to about 300 vendors during Fiscal Years 2013 and 2014, through May 14, 2014. Some vendors were paid in both fiscal years. Connect for Health was unable to provide a breakdown of payments to vendors made with federal funds by expense category. However, Exhibit 2.1 shows a summary of expenses related to vendors, by expense category, that were recorded in the general ledger in Fiscal Years 2013 and 2014, through May 14, 2014, the period we audited. The total amount of recorded expenses for vendor goods and services shown in Exhibit 2.1 differs from the total payments to vendors that Connect for Health recorded because some expenses were invoiced and recorded in one fiscal year and paid in the following fiscal year.

**EXHIBIT 2.1. RECORDED EXPENSES RELATED
TO VENDORS (IN MILLIONS)
FISCAL YEARS 2013 AND 2014, THROUGH MAY 14, 2014**

EXPENSE CATEGORY	2013	2014
Customer Service	\$ 1.4	\$ 19.4
Fixed Assets ¹	12.6	18.9
IT Technology and Consulting	9.4	17.0
Prepaid Expenses ²	4.3	11.3
Marketing and Outreach	2.3	7.2
Operations and Training	1.0	3.4
General and Administrative	0.5	1.1
TOTAL	\$ 31.5	\$ 78.3

SOURCE: Office of the State Auditor's analysis of Connect for Health's general ledger.

¹ Includes website development and testing; equipment, furniture, and improvements for the Colorado Springs call center and main office; and software licenses.

² Includes prepaid insurance, rent, software support, and website hosting.

Connect for Health management and staff working in the operational areas described above, select vendors, procure goods and services, receive invoices or payment requests from vendors, approve them for payment, and provide the approvals to accounting staff. Accounting staff and contractors are responsible for recording the transactions in Connect for Health's Intacct accounting system, tracking the source of funds (e.g., federal grant funds or private funds) used to pay each bill, and paying vendors by check. The Chief Financial Officer (CFO) or Controller is responsible for approving staff to print checks, and the Executive Director signs each check before it is mailed to the vendor.

To obtain federal grant funds to cover expenses, Connect for Health uses the Centers for Medicare and Medicaid (CMS) Payment Management Services System. Multiple times each month, accounting staff use the Payment Management Services System to electronically submit and request a portion of the federal grant award, which is typically an amount to cover expenses. CMS does not require documentation to support the requested amount and electronically deposits the federal funds requested into Connect for Health's operating account within about 1 business day of the request.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of our audit work in this area was to determine whether Connect for Health has sufficient processes and controls for procuring goods and services from vendors to ensure public funds are used for allowable, reasonable, and appropriate purposes based on applicable federal laws and regulations. We also assessed whether payments to vendors followed Connect for Health's written policies and procedures.

As part of our audit work, we reviewed a sample of 66 transactions with vendors totaling \$9.7 million in payments made in Fiscal Years 2013 and 2014, through May 14, 2014. For each sampled payment, we reviewed Connect for Health's electronic general ledger accounting data and the documentation it had on file, such as invoices, receipts, cancelled checks, email correspondence with vendors, bank statements, and evidence of review by Connect for Health management and staff. We reviewed the sampled payments to determine whether they were: (1) prudent and allowable uses of federal grant funds as defined by federal laws and regulations, (2) supported by documentation explaining the goods and services provided and payment amounts as required by federal regulations, and (3) reviewed and approved by financial management and supervisors as required by internal procedures.

As part of our work, we reviewed applicable federal laws, regulations, and grant requirements and Connect for Health's written procedures and general financial controls. We also interviewed Connect for Health management and staff to understand the purpose of each sampled transaction and the organization's practices for purchasing goods and services from vendors.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

As a recipient of about \$136.5 million in federal funds as of September 2014, with the potential to receive about \$41.2 million in additional federal funds through 2014, Connect for Health is responsible for ensuring those funds are safeguarded and spent efficiently and effectively on behalf of the citizens of Colorado. We applied the following criteria to assess the sufficiency of Connect for Health's practices for using federal funds to procure goods and services from vendors:

- **RECIPIENTS OF FEDERAL FUNDS MUST HAVE AN ADEQUATE SYSTEM OF INTERNAL CONTROLS OVER FINANCIAL TRANSACTIONS.** The federal Office of Management and Budget's (OMB) *Circular A-110, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations (Circular A-110)*, outlines standards for financial management systems and methods for making payments for non-profit organizations that receive federal funds, including Connect for Health. Specifically, *Circular A-110* states that recipients of federal funds shall adequately safeguard all assets by establishing internal controls such as reconciliations and supervisory reviews, assure funds are used solely for authorized purposes, and maintain accounting records that are supported by source documentation [Sections 215.21(b)(3) and (b)(7)].

In addition, the Department of Health and Human Services (HHS), which provides grants to states to establish state health exchanges, requires each grantee, including Connect for Health, to maintain financial controls. The HHS Grants Policy Statement requires recipients of federal grants to maintain accounting records that adequately identify the purposes for which the funds were used; document authorizations; and ensure accounting records are supported by source documentation such as canceled checks, paid bills, payrolls, and time and attendance records.

- **SERVICES AND GOODS PURCHASED WITH FEDERAL FUNDS MUST BE REASONABLE, NECESSARY, AND ALLOWABLE.** OMB’s *Circular A-122, Cost Principles for Non-Profit Organizations (Circular A-122)*, provides guidelines on the types of costs or expenses that are allowable using federal grant funds. These guidelines state that the costs charged to a federal award must be necessary, reasonable, and adequately documented. *Circular A-122* defines a reasonable cost as one that, in its nature or amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs; the cost should be generally recognized as ordinary and necessary for the operation of the organization. *Circular A-122* further states that the reasonableness of specific costs must be scrutinized with particular care for organizations that receive most of their funding from federal awards.

The Affordable Care Act also specifies that certain expenses are unallowable using federal funds. The Affordable Care Act prohibits exchanges from using federal funds for staff retreats, promotional giveaways, excessive executive compensation, or promotion of Federal or State legislative and regulatory modifications [42 USC 18031(d)(5)(B)]. Further, *Circular A-110* prohibits recipients of federal funds from paying contracted vendors using the “cost plus a percentage of cost” method, which is paying the contractor for actual costs plus an additional percentage of those costs as profit or additional compensation [Section 215.44(c)].

- **DEFINITION OF QUESTIONED COSTS.** OMB’s *Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*, states that a questioned cost is a cost that is questioned by the auditor because of an audit finding that: (1) resulted from a violation or possible violation of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds; (2) identified costs that at the time of the audit testwork were not supported by adequate documentation; or (3) identified incurred costs that appeared unreasonable and did not reflect the actions a prudent person would take in the circumstances.

- **CONNECT FOR HEALTH REQUIRES SUPERVISORY REVIEW AND APPROVAL OF PAYMENTS.** According to Connect for Health’s May 2013 written Financial Procedures, which management stated were being followed at the time of our review, staff can select the vendor, make the purchase, receive and approve the invoice, and then forward the invoice to a supervisor or the CFO for approval. Specifically, the written procedures state that invoices are authorized for payment by the party who requested the service or purchase, and payments for goods or services are made when an appropriate invoice is received and approved by the supervisor or CFO. Further, the procedures state that the CFO or Controller performs a supervisory review of all invoices for approvals from the staff who made the purchases, and verifies that goods or services were received. The Financial Procedures also require the Executive Director to approve all payments.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

Overall, we identified one or more problems with 21 of the 66 sampled payments (32 percent) that we reviewed. We found that Connect for Health paid for some services and goods that were unallowable, unreasonable, or unnecessary; paid some vendors without evidence of how the payment amounts were determined or documentation of the services provided; and supervisors did not consistently approve expenses before staff paid vendors. These problems with 21 sampled payments totaled \$381,671 and resulted in \$156,937 in questioned costs because of noncompliance with federal requirements. The problems that we identified are described below.

- **TWO SAMPLED PAYMENTS TOTALING \$46,998 WERE UNALLOWABLE UNDER FEDERAL REQUIREMENTS:**
 - ▶ One sampled \$38,344 payment to a vendor for 100,000 tubes of lip balm in February 2014 was unallowable because the items were used as a promotional giveaway, which is specifically prohibited by the Affordable Care Act [42 USC 18031]. In September 2014, Connect for

Health staff reported to us that it would follow-up with HHS for guidance regarding this expense. This \$38,344 is questioned costs.

- ▶ One vendor was paid cost plus an additional amount of \$8,654 for 15 percent of the cost of services in October 2013, although paying vendors using the “cost plus a percentage of cost” method is prohibited by *Circular A-110*. Connect for Health staff reported that they were not aware that this type of payment method was prohibited. This \$8,654 is questioned costs.
- **ONE SAMPLED PAYMENT INCLUDED \$584 THAT APPEARED UNREASONABLE OR UNNECESSARY.** One vendor was paid \$584 in December 2013 for personal travel expenses without evidence of the business need for the expense and out of compliance with *Circular A-122*. Connect for Health hired this vendor to train the contractor’s staff at the Arizona call center. Connect for Health paid for the trainer to make two roundtrip flights from Denver to the Arizona call center within a 3-day period. There was no documentation of the business purpose for the second roundtrip flight. Connect for Health staff stated that they paid for the second flight because the trainer had personal business in Denver on one of the training days and Connect for Health believed it was reasonable to use federal funds to pay for those additional travel expenses. This \$584 is questioned costs.
- **SEVEN SAMPLED PAYMENTS TOTALING \$109,355 LACKED EVIDENCE TO SUPPORT THE AMOUNTS PAID AND SERVICES PROVIDED WHEN PAID.** For these sampled payments, we could not determine, and Connect for Health could not demonstrate, that the payment amounts were accurate based on the service provided or that all federal funds were used for appropriate and allowable services. Specifically, we found:
 - ▶ For four sampled payments totaling \$100,871 made to three vendors between October 2012 and December 2013, the vendors’ invoices did not explain the basis for the payments or the work the vendors performed. Connect for Health staff stated that these vendors educated the public about Connect for Health and provided upgrades to the electronic health plan rate reporting system, but Connect for

Health did not have documentation to support these statements. This \$100,871 is questioned costs.

- ▶ For two sampled payments totaling \$5,176 to two vendors in December 2013 and January 2014, Connect for Health did not have support for the payments that the vendors had requested, so we could not determine how the payments were calculated. Specifically, for one sampled \$4,200 payment, Connect for Health did not have an invoice or other support for the amount the vendor billed or explaining why staff paid it. Staff stated that the payment was for a rental space deposit to train customer service assistants but did not have documentation to support the basis for the payment amount. This \$4,200 is questioned costs.

Another vendor sent Connect for Health an invoice for shipping services for one amount, staff handwrote a second payment amount on the invoice, and then staff paid \$976 which differed from the invoice and handwritten amounts. Although the payment was less than the invoiced amount, the payment amount was not supported by the documentation. Management stated that the \$976 was based on staff's phone call with the vendor; however, we could not confirm this statement or determine the basis for the payment amount. This \$976 is questioned costs.

- ▶ For one \$183,507 payment made in April 2014, Connect for Health lacked supporting documentation for \$3,308 of the payment. The vendor was hired to review health insurance plans before they are sold on Connect for Health's website and billed Connect for Health \$3,308 for travel and office supply expenses; however, Connect for Health did not have documentation to support these expenses when it made the payment. After our testwork, Connect for Health obtained receipts from the vendor to support the travel and supply costs but it did not have this documentation when it made the payment. This \$3,308 is questioned costs.
- **THIRTEEN OF THE 66 SAMPLED PAYMENTS (20 PERCENT) TOTALING \$229,518 WERE MADE WITHOUT THE REQUIRED SUPERVISORY REVIEW.**

Specifically, these 13 sampled payments were made between June 2013 and March 2014 for consulting, training, graphic design, and janitorial services, and did not have any evidence of review by a supervisor, as did the other 53 sampled payments. Although Connect for Health's Executive Director had approved for staff to pay each of the 13 transactions, there was no evidence that the supervisors, CFO, or Controller had reviewed the invoices or supporting documentation for required approvals and to ensure that Connect for Health received the goods or services billed by vendors, as required by Connect for Health Financial Procedures.

In addition to the problems that we identified with payments to vendors, we identified problems with some of the vendors' written contracts and contract compliance. These problems are described in Finding and Recommendation 2.

WHY DID THESE PROBLEMS OCCUR?

Overall, Connect for Health has not established adequate financial controls over purchases from vendors. At the time of the audit, Connect for Health had some financial procedures and internal controls over financial expenditures; however, we found that the procedures were not always followed, did not address the problems we identified, or were not sufficient to ensure adequate controls over the use of public funds and federal compliance. We identified the following reasons for the problems with payments to vendors:

- **INSUFFICIENT POLICIES, PROCEDURES, AND GUIDANCE FOR ENSURING PAYMENTS ARE REASONABLE AND APPROPRIATE.** According to some Board members, when the organization was created, the Board and management had to create policies and procedures but had little guidance to work with because Connect for Health was a new entity. At the time of our audit testwork, about 2 ½ years after Connect for Health began receiving federal funds, the organization had not established a written policy or procedure requiring staff to review documentation for compliance and reasonableness to ensure purchases using federal grant funds are allowed or prudent. Connect for Health

did not have a policy, procedure, or guideline for staff specifying the documentation needed to support each payment, such as invoices stating the good or service provided and itemizing the cost of each. Additionally, Connect for Health's Financial Procedures do not specify when the CFO or Controller should review payments, so the written procedures do not specifically require this accounting supervisory review before vendors are paid.

After providing Connect for Health the payment problems we identified, management reported that it had been revising existing financial procedures and developing new processes. One staff member reported to us that although Connect for Health had written Financial Procedures, this individual did not believe there were processes or guidance to follow at the time of our audit. In September 2014, Connect for Health provided revised written procedures related to some of its financial processes and reported that it had implemented new electronic bill approval and check signing processes. Although Connect for Health has taken some steps to improve its written procedures, we found the procedures did not specifically address the payment problems identified in the audit. The deficiencies we identified and the associated questioned costs indicate a need for continued improvement.

- **LACK OF STAFF KNOWLEDGE OR UNDERSTANDING OF FEDERAL REQUIREMENTS FOR THE USE OF GRANT FUNDS.** Based on interviews and discussions during the audit, some financial staff were not aware of federal requirements for using the federal grant funds. For example, some staff were not aware of documentation requirements to support payments with federal funds, and some were not aware that paying vendors cost plus a percentage was prohibited, indicating the need for additional staff training and guidance on federal compliance requirements. This problem also indicates the need for Connect for Health to review all payments it made to vendors using the cost plus a percentage method to identify and recover unallowable costs.

- **PRIORITIZATION OF QUICK PAYMENTS WITHIN TIGHT FEDERAL DEADLINES TO IMPLEMENT THE EXCHANGE.** Some Connect for Health

management and staff we interviewed stated that, prior to October 2013, the organization had been focused on timely implementation of the exchange by October 1, 2013 and were operating under tight deadlines to meet that goal. After October 2013, management and staff shifted their focus from exchange implementation to enrolling consumers in health plans. Overall, the organization prioritized spending federal grant funds and purchasing services quickly over developing a system of financial controls for the use of federal funds. During the audit, some Board members stated that they would like to shift their role from developing Connect for Health's operations to oversight and planning for the future of the State's health exchange.

- **INSUFFICIENT PROCESSES TO MONITOR PAYMENTS AND TURNOVER OF KEY STAFF.** Despite having a written financial procedure requiring the CFO or Controller to review invoices and verify the receipt of goods and services, staff did not consistently follow this procedure, and management did not confirm that this review had occurred. At the time of our audit, Connect for Health did not have a sufficient internal monitoring and review process to ensure compliance with federal requirements or internal procedures.

Further, Connect for Health did not have a Controller between November 2013 and February 2014, and as a result, the CFO performed the Controller and CFO duties during this period. In addition, the accounts payable accounting staff resigned in March 2014, and at the end of our audit, management reported to us that it had identified problems with financial controls and overdue invoices between March and May 2014. According to the general ledger, from November 2013 through May 2014, payments to vendors averaged 166 checks and \$8.7 million per month. During this time, Connect for Health did not appear to have enough staff or supervisors with the expertise or time needed to review the large volume of payments and ensure they were appropriate and supported.

WHY DO THESE PROBLEMS MATTER?

Connect for Health's current processes can allow for the organization to receive goods and services quickly. However, when Connect for Health does not have sufficient controls over expenditures to reduce the risk of fraud, waste, abuse, and errors, it can result in inappropriate expenditure of federal grant monies, as identified in this audit. According to Connect for Health's Financial Procedures, staff who select or purchase services from vendors also receive the invoice and approve the payment. Without a consistent secondary financial review by the Controller or CFO, Connect for Health may not be able to ensure the payments or services that staff procure are reasonable and appropriate. When Connect for Health pays for unallowable or unnecessary goods and services, it is not a prudent use of public funds.

When Connect for Health cannot demonstrate that public funds were used in compliance with laws, regulations, and key financial controls, there is a risk that the organization's costs will be higher than if controls over the funds were in place and operating effectively. Higher costs can directly impact affordability for consumers and small businesses because Connect for Health charges insurance carriers and small businesses administrative fees that are based on Connect for Health's projections of its future operating costs. The federal Patient Protection and Affordable Care Act and the State's legislative declaration (Section 10-22-102, C.R.S.) creating the Colorado Health Insurance Exchange states that the exchange is intended to, "increase access, AFFORDABILITY, and choice for individuals and small employers purchasing health insurance in Colorado" (EMPHASIS ADDED). If administrative fees reflect the costs of unallowable or unnecessary expenses, these costs could be passed on to small businesses and Coloradans through their premiums.

In addition, the Affordable Care Act [42 USC 18031(d)(5)(A)], requires all state exchanges to be self-sustaining beginning on January 1, 2015. This means that, after this date, Connect for Health is expected to be self-sustaining without federal grant funds, and state general funds are not appropriated to supplement its revenues [Section

10-22-108, C.R.S.]. Connect for Health will be expected to generate enough revenue to cover its costs. As of June 2014, Connect for Health's management had estimated that its revenue will decline from about \$48.9 million in 2015 to \$26.4 million by 2017. When Connect for Health does not have sufficient controls over spending and purchases, there is a risk of improper payments that can increase its costs and limit its ability to budget and pay for future expenditures. Given that future revenue growth may be limited, it is important that Connect for Health ensures that all expenses are reasonable and necessary.

CLASSIFICATION OF FINDING: SIGNIFICANT DEFICIENCY

RECOMMENDATION 1

Connect for Health Colorado should improve processes and controls over the purchase of goods and services from vendors by:

- A Establishing and implementing written policies and procedures that: (1) require documentation of all goods and services that supports the payment amount and business purpose prior to paying vendors, (2) specify the types of documentation required to verify the receipt of goods and services prior to payment, and (3) require all payments to be allowable, compliant, reasonable, and accurate.
- B Establishing and implementing written processes and guidance that ensure staff and supervisors understand federal compliance requirements and consistently review all pending payments for compliance, reasonableness, and accuracy before they are paid. Each review should be performed and documented by an individual who is independent of the preparer and possesses sufficient knowledge of compliance and accounting requirements.
- C Ensuring that there is an adequate number of supervisors and staff available to review financial documentation, verify the basis for the billed amounts, and ensure goods and services are received prior to paying vendors.
- D Establishing and implementing a risk-based process for expediting low-risk purchases, such as low-dollar recurring administrative expenses, to expedite the procurement process, as appropriate, during times of high workload within the organization.
- E Implementing an ongoing periodic monitoring process that involves members of the Board of Directors (Board), management, and supervisors, as appropriate, to ensure financial policies, procedures, processes, guidance, and training are implemented and operating as intended.

- F Training management, supervisors, staff, and Board members, as appropriate, on the policies, procedures, processes, and guidance developed in recommendation PARTS A THROUGH E.
- G Recovering payments for the unallowable costs and payment errors identified in this audit, including identifying and recovering payments to vendors made using the cost plus a percentage method and reporting the results of these efforts to the Board. This should include reviewing current vendor contracts to identify those allowing the cost plus a percentage payment, revising the contracts, and prohibiting future contracts from allowing this payment method.

RESPONSE

CONNECT FOR HEALTH COLORADO

- A AGREE. IMPLEMENTATION DATE: FEBRUARY 2015.

Connect for Health Colorado will establish and implement additional written policies and procedures that: (1) require documentation of goods and services that supports the payment amount and business purpose prior to paying vendors, (2) specify the types of documentation required to verify the receipt of goods and services prior to payment, and (3) require all payments to be allowable, compliant, reasonable, and accurate. Connect for Health will continue to update, on an ongoing basis, written financial and personnel policies and procedures reflective of the evolving nature of the organization and its staff moving from a start-up toward a stable, established entity. Connect for Health will continue to improve and add to these policies to specify the documentation required to verify the receipt of goods and services prior to payment and require all payments to be allowable, compliant, reasonable, and accurate. New accounting staff will be instructed on use and management of the goods and services payment systems and documentation requirements.

- B AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado will establish and implement additional written processes and guidance that ensure staff and supervisors

understand federal compliance requirements and consistently review all pending payments for compliance, reasonableness, and accuracy before they are paid. Each review will be performed and documented by an individual who is independent of the preparer and possesses sufficient knowledge of compliance and accounting requirements. Connect for Health will update written financial and personnel policies and procedures with respect to federal compliance requirements and ensure compliance with federal oversight as the organization's structure and staffing evolves. Connect for Health is working with General Counsel and finance staff to update and improve the system for approving vendors and contracts prior to full execution and engagement with vendors to ensure compliance, reasonableness, and accuracy. This review shall be performed and documented by several individuals, including General Counsel, managerial and/or executive staff, and the Controller before final entry into the accounting system for payment submission, and ultimately must be approved with the CEO/Executive Director's signature.

As new staff are hired, consideration will be given to individuals with federal compliance experience. Current staff will be trained as needed on federal guidelines as well. Connect for Health will continue to improve these policies as organizational growth and sophistication warrant, ensuring that staff and supervisors understand federal compliance requirements and consistently review all pending payments for compliance, reasonableness, and accuracy before they are paid.

C AGREE. IMPLEMENTATION DATE: JUNE 2015.

Connect for Health Colorado agrees with the audit findings regarding adequate number of supervisors and staff needed to review financial documentation. As the timeline below demonstrates, the finance department was not fully staffed until May of this year.

- 01/2012–Hired contract financial officer to help implement organization
- 08/2012–Brought on full-time CFO
- 12/2012–Hired first full-time Controller
- 2013–Added full-time financial staff
- 02/2014–Hired new Controller
- 04/2014–Hired Accounts Payable Specialist
- 05/2014–Implemented Bill.com, trained staff on Bill.com in All Staff Meeting, and hired Grant Accounting Coordinator
- 10/2014–Added temporary Assistant Controller during the CFO search, and

actively seeking new CFO by retaining professional search firm with anticipated hire date as soon as feasible. First priority is hiring for CEO/Executive Director position.

Currently, Connect for Health is seeking a new CFO and after this individual is hired, staff requirements will be reviewed again and new staff hired as needed. The goal will be to ensure there is an adequate number of supervisors and staff available to review financial documentation, verify the basis for billed amounts, and ensure goods and services are received prior to paying vendors. On September 2, 2014, Connect for Health transitioned from a staff legal counsel to retaining general counsel with over 25 years of experience to assist in implementing an organization-wide governance and compliance program addressing the breadth and scope of the each recommendation provided by the Office of the State Auditor.

D AGREE. IMPLEMENTATION DATE: DECEMBER 2014.

Connect for Health Colorado agrees with the audit findings and will have a corporate credit card for expediting low-risk purchases and a process by the end of November 2014. A policy is currently being drafted detailing the use of this card and staff will be informed and trained as needed in December 2014.

E AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado will implement an ongoing periodic monitoring process that involves members of the Board, management, and supervisors, as appropriate, to ensure financial policies, procedures, processes, guidance, and training are implemented and operating as intended. Executive management will review and approve financial policies and implementation of new policies and procedures. The Board and its Finance Committee will be advised on improvements in financial reporting and budget reporting. Accounting staff will use multiple reporting tools to provide information to the Board, management, and supervisors with respect to new developments, processes, and procedures, and to provide overall transparency and facilitate appropriate control and oversight. Periodic review and spot checks of implemented policies and procedures will occur as a function of the use of Connect for Health's accounting systems and record-keeping and record-retention requirements.

F AGREE. IMPLEMENTATION DATE: JUNE 2015.

Connect for Health Colorado will provide training as needed to management, supervisors, staff and Board members as appropriate, on the policies, procedures, processes, and guidance developed in Recommendation 1, parts A through E. Training and information will be communicated in person at all-staff meetings twice per month, through required on-line training modules each employee must pass upon hire (and annually re-certify), and through internal publication of a common repository of established policies and procedures.

With the hire of General Counsel, Connect for Health is implementing an organizational-wide oversight, monitoring, and compliance program – a description of which was submitted to the Centers for Medicare and Medicaid Services, Center for Consumer Information and Insurance Oversight, on October 17, 2014.

G AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado will conduct an internal audit by the end of this year to identify unallowable costs, and an adjustment will be made in the Intacct accounting system to reclassify the funding source to non-federal grant funds. An internal tracking process will be used to ensure that the next request for payment from the payment management system is reduced by that amount. With ongoing internal auditing, unallowable costs will be identified and adjusted accordingly.

The Board's Finance Committee will be advised on all identified costs, payments, and corrective actions with respect to material agreements. General Counsel (or other appropriate legal staff) will review each material agreement for compliance with applicable regulatory requirements and other transactional best practices. For vendors with a continuing relationship with Connect for Health, oversight processes for vendor payments will be used to recover or net out vendor payments to eliminate overpayments or other identified accounting errors.

ADMINISTRATION OF FEDERALLY-FUNDED CONTRACTS

When Connect for Health began developing Colorado’s health exchange in 2012, its deadline was to ensure the marketplace was fully operational to enroll consumers in October 2013. To meet that timeframe, Connect for Health contracted with vendors to provide the following types of services and goods to establish the health exchange and support basic office functions:

- **CUSTOMER SUPPORT** such as call center construction, staffing, and training to educate and assist consumers in enrolling in health plans.
- **IT DEVELOPMENT, SUPPORT, AND SECURITY** related to the marketplace website; software licenses and maintenance; IT consultants; and office internet and phone connectivity.
- **MARKETING AND PUBLIC RELATIONS** such as media consulting and advertising to increase awareness of Connect for Health’s services.
- **ADMINISTRATIVE SUPPORT** such as project management assistance, accounting, legal consulting, and property management and maintenance.

Connect for Health’s Executive Director and staff select the contractors, while the Board has authorized the Executive Director to negotiate all contracts. During the audit, management stated that staff maintained a detailed list of contracts that included contractor names and the contract amounts, paid contractors when billed, and recorded the payments in the general ledger. We asked management to provide the list that was used to track and otherwise administer contracts. Connect for Health provided a contract spreadsheet that included each

contractor's name and contract award amount, where applicable. According to Connect for Health's contract spreadsheet and general ledger, during Fiscal Years 2013 and 2014, through May 14, 2014, it executed contracts with approximately 141 vendors; the individual contract amounts ranged from \$360 to \$29.9 million. Some of these vendors had more than one contract. According to Connect for Health's general ledger, the organization paid these 141 vendors about \$112.2 million in federal funds during Fiscal Years 2013 and 2014, through May 14, 2014.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of the audit work was to evaluate whether Connect for Health has sufficient processes for administering its federally-funded contracts with vendors to ensure public funds are used efficiently, effectively, in compliance with federal regulations and grant requirements, and in line with internal written financial policies and procedures. We also assessed whether Connect for Health's contracts complied with federal requirements and were sufficient to help ensure contractors provided services for the contracted amounts. We did not evaluate the quality of contractor services.

As part of our audit work, we sampled 53 vendors that Connect for Health paid during Fiscal Years 2013 and 2014, through May 14, 2014, and reviewed the electronic general ledger and contract tracking spreadsheet to identify whether vendors that were paid \$150,000 or more had a written contract in place, as required by federal regulations. We assessed the sufficiency of Connect for Health's contracts by reviewing a sample of 22 contracts with vendors from Fiscal Year 2014 to determine whether they supported the payments to vendors, were complete, and met federal requirements. We reviewed Board meeting minutes and interviewed Board members and staff to determine whether the sampled contracts had been approved by the Board before they were awarded as required by Connect for Health's procedures.

In addition, we reviewed Connect for Health’s financial and procurement policies and procedures and Board meeting minutes, and interviewed Connect for Health management, staff, and Board members to determine processes for approving and executing vendor contracts and understand controls over payments to contractors.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

As the administrator of more than 140 federally-funded contracts and the payer of more than \$112 million to contractors, Connect for Health must have sufficient processes and controls to ensure public funds used for contracts comply with federal requirements and internal policies and procedures, and are spent in an effective and efficient manner. We applied the following criteria when evaluating Connect for Health’s practices for paying contractors with federal funds and administering federally-funded contracts:

- **FEDERAL REGULATIONS AND GUIDANCE REQUIRE EFFECTIVE CONTRACT ADMINISTRATION AND FINANCIAL CONTROLS.** Federal OMB *Circular A-110, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non Profit Organizations (Circular A-110)*, requires non-profit organizations, such as Connect for Health, to maintain a system of contract administration to, “ensure contractor conformance with the terms, conditions, and specifications” in the contract (Section 215.47). As a general best practice, effective contract administration includes developing a clear statement of work, measuring contractors’ performance to ensure they are held accountable for deliverables, and maintaining documentation demonstrating that contractors are paid according to their performance and contract terms.

The federal HHS Grants Policy Statement specifies that the contracts issued by recipients of federal grants must, “state the activities to be performed; the time schedule; the policies and requirements that apply to the contract;...and the maximum amount of money for which the

recipient may become liable...under the agreement.” Contracts should be complete and fully executed, meaning they should be signed by Connect for Health and the vendor, include the work to be performed, specify the method and amount of payment, and specify the time period when the contract is valid.

Further, OMB *Circular A-110* requires recipients of federal funds, including Connect for Health, to have “effective control over and accountability for all funds” and “adequately assure they are used solely for authorized purposes” (Section 215.21). OMB *Circular A-122*, Attachment B, also specifies that the organization may not pay for certain lobbying activities, such as attempting to influence the outcome of elections and influencing legislation.

- **INTERNAL POLICIES AND PROCEDURES REQUIRE BOARD APPROVAL OF MAJOR PROPOSED EXPENDITURES AND FOR THE EXECUTIVE DIRECTOR TO SIGN CONTRACTS.** The Board’s Articles of Governance specify that the Executive Director shall be the principal officer for the purpose of entering into contracts on behalf of Connect for Health and shall have the authority to enter into contracts with Board approval or enter into contracts without approval up to a dollar amount to be set by the Board.

Connect for Health’s Procurement Policy specifies that all proposed expenditures in excess of \$150,000 are subject to Board approval and its Consultant Procurement Policy states that the Board’s Finance Committee must approve contracts with consultants that are \$150,000 or more annually. Connect for Health’s Financial Procedures state that all contracts over \$5,000 must be authorized by the Executive Director. The policies and procedures do not specify a minimum dollar threshold required to execute a contract with a vendor or specify when the Board approval occurs. According to Connect for Health management, in practice, the organization executes written contracts with most vendors regardless of the purchase amount and the Board has approved the Executive Director to negotiate and execute contracts.

- **FEDERAL REGULATIONS REQUIRE THAT CONTRACTS INCLUDE CERTAIN LEGAL PROVISIONS.** Federal Acquisition Regulations promulgated by the Federal Acquisition Regulatory Council set the simplified acquisition threshold at \$150,000. OMB’s *Circular A-110*, Section 215.48 requires federal fund recipients, including Connect for Health, to include the following provisions in contracts that exceed the \$150,000 simplified acquisition threshold (also known as the small purchase threshold):
 - ▶ Provisions that “allow for administrative, contractual, or legal remedies” if the vendor breaches the contract terms. These provisions provide Connect for Health with a resolution should the vendor violate the contract.
 - ▶ Provisions that allow “termination by the recipient [of federal funds],” including the manner by which the recipient, which is Connect for Health, will terminate the contract and conditions for termination. These provisions allow Connect for Health to determine how and when to terminate the contract for vendor noncompliance.
 - ▶ Provisions that allow HHS, the Comptroller General, and the recipient of federal funds, which is Connect for Health, to audit vendors and access “any books, documents, papers, and records which are directly pertinent to a specific program for the purpose of making audits.”

In addition, Appendix A of OMB *Circular A-110* requires federal fund recipients, including Connect for Health, to include an equal employment opportunity clause in all contracts, regardless of amount, which states the vendor will not discriminate against any employee or employment applicant because of race, creed, color, or national origin.

- **INTERNAL PROCUREMENT POLICIES REQUIRE COMPLIANCE WITH FEDERAL PROVISIONS.** Connect for Health’s Procurement Policy requires procurement contracts to include federally required provisions in addition to “the usual and customary terms of a commercially reasonable agreement.” The policy does not specify

what are considered “usual and customary terms” or define “a commercially reasonable agreement.”

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

We found that Connect for Health did not administer its contracts in compliance with its internal policies and procedures or follow all applicable federal requirements. We identified one or more problems with 20 of the 22 sampled contracts (91 percent) from Fiscal Year 2014, and 29 of the 53 sampled vendors (55 percent) that we reviewed. We identified instances where Connect for Health did not execute contracts before paying vendors; paid contractors out of compliance with contracts, or paid more than the contracts allowed; did not obtain Board approval for some high-dollar contracts; and executed contracts that were incomplete or insufficient to ensure public funds are used effectively. The problems we identified with Connect for Health’s contracts totaled \$31,639,461 and resulted in \$170,296 in questioned costs because of noncompliance with federal requirements or contract terms. These problems are described in the following sections.

CONTRACT EXECUTION AND COMPLIANCE

We identified payments to vendors before contracts were executed, contractors paid out of compliance with their contracts, and contractors paid more than their contracted amounts. We found:

- **THREE SAMPLED VENDORS WERE PAID A TOTAL OF \$145,824 WITHOUT FULLY EXECUTED CONTRACTS OR AFTER THE CONTRACT EXPIRED.** Specifically:
 - ▶ One vendor was paid \$128,798 for outreach services before it signed a contract. Further, the contract, which was for \$144,072 in services,

was not signed by Connect for Health's Executive Director; it was signed by a staff member who was not authorized to sign contracts on behalf of Connect for Health.

- ▶ One vendor was paid \$13,468 for strategic and business development before it signed a contract. The contract was for \$20,380 in services.
- ▶ One vendor was paid \$3,558 for information technology support after its contract had expired and without a new contract or addendum. According to Connect for Health staff, this vendor continued to provide services after the contract had expired but the vendor did not have a new contract.
- **FOUR SAMPLED CONTRACTORS WERE PAID A TOTAL OF \$170,296 OUT OF COMPLIANCE WITH THEIR CONTRACTS. Specifically:**
 - ▶ One contractor was paid \$134,696 in July 2013 without providing Connect for Health with its staff timesheets, which the contract specifically required as a basis for the vendor's billing. Connect for Health obtained the contractor's 2013 timesheets in August 2014, but based on the documentation, Connect for Health did not have the timesheets at the time of payment in order to determine the basis for the payment. This \$134,696 is questioned costs.
 - ▶ One contractor was paid \$25,000 in December 2013 before providing services and without documentation to support the payment. This vendor's contract specified that payment should occur after the work is completed. This \$25,000 is questioned costs.
 - ▶ One contractor was paid \$9,700 to provide training to insurance brokers in September 2013, and Connect for Health could not demonstrate that the contractor provided the training in compliance with the contract. The vendor's contract required the training participants to rate the trainer's performance and required the trainer to receive an average score of between 3.5 and 4 on a 5-point scale. Connect for Health did not require staff to score the trainer's performance, but staff did complete a training survey. Some staff

provided positive comments while other staff commented that the trainer did not appear qualified to teach the training and that the training was not effective. This \$9,700 is questioned costs.

- ▶ One vendor who provided staff training in December 2013 was paid \$900 more than the contracted rate, which should have been \$3,600, without any documentation to support the overpayment. This \$900 is questioned costs.

- **TWENTY-FIVE OUT OF 141 CONTRACTORS (18 PERCENT) WERE PAID A TOTAL OF \$10,571,808 MORE THAN THEIR CONTRACTED AMOUNTS.** First, when we reviewed the 22 sampled contracts from Fiscal Year 2014, we identified 7 contractors (32 percent) who were paid from \$56,657 to \$4,681,699 more than their contracted amounts. For example, one contractor was paid \$4,681,699 more than its \$6,397,431 contract amount for call center implementation services; another vendor was paid \$2,512,049 more than its \$6,118,970 contract amount for media and advertising services. Based on our review of Connect for Health's documentation, we were not able to determine whether the contractors provided services for the additional funds they received.

Second, upon identifying this problem during the sample review, we assessed whether any of the other 119 contractors that were not sampled had been paid more than their contracted amounts by comparing the contract amounts for each contractor listed in Connect for Health's contract tracking spreadsheet to the general ledger showing payments to each vendor. We identified an additional 18 of the 119 contractors outside of our sample that appeared to be paid more than their contracted amounts during Fiscal Year 2014, ranging from \$504 to \$676,514 more than their contracts. After discussing these problems with Connect for Health, management reported to us that the contract tracking spreadsheet that it had provided was inaccurate and incomplete.

BOARD APPROVALS OF CONTRACTS

We identified problems with Board approvals for 16 of the 19 sampled contractors (84 percent) that were paid more than \$150,000. Exhibit 2.2 summarizes the problems identified.

EXHIBIT 2.2. PROBLEMS IDENTIFIED WITH BOARD APPROVALS OF CONTRACTS		
DESCRIPTION OF PROBLEM	NUMBER OF CONTRACTS WITH A PROBLEM	AMOUNT PAID TO VENDORS
Board Did Not Approve Contract that Exceeded \$150,000	9	\$ 23,168,374
Board Did Not Approve Contracts for Contractors Paid More than \$150,000	2	\$ 899,204
Contracts were Executed for More than the Board-Approved Amount	2	\$ 3,858,773
Board Not Informed of the Contract Amounts	3	\$ 9,117,082

SOURCE: Office of the State Auditor's analysis of Connect for Health's general ledger and contracts data.

The specific problems that we identified are:

- **THE BOARD DID NOT APPROVE 13 CONTRACTS OR PAYMENTS TO CONTRACTORS THAT WERE MORE THAN \$150,000.** Specifically:
 - ▶ The Board did not approve nine of the sampled contracts that were more than \$150,000, as required by internal policy:
 - One \$601,400 contract, one \$384,200 contract, and one \$184,675 contract that were for IT services or IT consulting were not approved by the Board. In addition, one \$274,000 contract for public relations services was not approved by the Board.
 - The Board did not appear to approve the contracts for five contractors that were paid a total of \$21,943,952. The contracted amounts were \$6,397,431 for the implementation of a call center, \$5,803,188 for a software license and support, \$5,476,933 for another software license and support, \$644,000 for furniture in the

call center, and \$382,260 for the implementation of a security risk management program. In May 2012, the Executive Director received approval from the Board to negotiate contracts with any vendor that was considered a “vendor partner” of Connect for Health’s primary IT contractor. However, the Board minutes did not indicate that the Board approved the five contracts with the IT vendor’s partners before or after they were executed, and the minutes did not name these other vendors, specify the estimated costs or contract amounts, or note the services the vendors would provide. Board members that we interviewed and who were on the Board in 2012 could not recall discussing or approving two of these five contracted vendors. Connect for Health also paid two of these five vendors more than their contracted amounts, as discussed in the previous section.

- ▶ The Board did not approve two contracts that were originally under \$150,000 but where the contractors were paid more than \$150,000 after the contracts were executed:
 - One contractor had an \$86,400 contract for IT consulting but was paid \$536,661 or 521 percent more than the contracted amount without Board approval.
 - One contractor had a \$144,072 contract for outreach services but was paid \$362,543 or 157 percent more than the contracted amount without Board approval.
- ▶ For two contracts that were originally approved by the Board, staff executed the contracts for more than the approved amount or paid the contractors more than the contracted amount without Board approval for the increases:
 - One contractor that had a \$350,000 contract that was approved by the Board was subsequently paid \$3,454,469 or 887 percent more than the Board-approved amount, and staff did not obtain Board approval for the overage.

- For one contract that the Board approved for \$845,425, Connect for Health staff subsequently executed a \$1,025,401 contract or 21 percent more than the Board-approved amount. Staff did not obtain Board approval for the different contract amount.
- **THE BOARD DID NOT RECEIVE COMPLETE INFORMATION ABOUT THREE CONTRACTS THAT WERE MORE THAN \$150,000.** For three contracts totaling \$7,447,353, Connect for Health management and staff reported the vendor names and contract purposes to the Board but did not report the estimated or total contract amount for each vendor. These contracts were \$6,118,970 for advertising production and media placement, \$1,168,383 for a website function to calculate consumers' out-of-pocket costs, and \$160,000 for testing the website's accessibility for individuals with disabilities. Based on the meeting minutes and interviews, the Board approved management to execute contracts with these vendors but the Board did not appear to receive information about the estimated costs to make informed decisions regarding these proposed vendor contracts.

INCOMPLETE CONTRACTS

We found that 19 of the 22 sampled contracts (86 percent) that Connect for Health executed with vendors were incomplete. Contracts were missing statements of work, other key provisions, or terms required by *Circular A-110*. The problems that we identified are:

- **FOUR SAMPLED CONTRACTS DID NOT STATE KEY PROVISIONS SUCH AS THE AGREED UPON SERVICES, THE CONTRACT TIMEFRAME, OR PAYMENT INFORMATION.** We found:
 - ▶ Two sampled contracts for vendors who were paid a total of \$129,720 did not include a statement of work detailing the services they were to provide. Specifically, one vendor who was paid \$128,798 had a contract that stated it would “advise and assist [Connect for Health]...to engage voters regarding health care... [through] development and management of the campaign’s paid canvass

operation (Paid Field Operation).” However, the contract did not describe the purpose of the campaign, and the vendor’s invoice did not describe the services provided or the basis for the payment amount. We were unable to determine whether this vendor provided lobbying services, which are prohibited under *Circular A-122*. Connect for Health management stated that this vendor contacted individuals and provided them marketing information about Connect for Health. Another contractor that was paid \$922 for accounting services did not have a statement of work included in the written contract.

- ▶ One contractor who was paid \$465 did not have a timeframe specified in the contract. This contract included a section titled “Period of Agreement” that should be used to specify when services would start and end; however, this section of the contract was blank.
- ▶ One vendor’s contract totaling \$113,010 was missing the payment schedule referenced in the contract, meaning it did not include a contract provision that specified the rate the vendor should have been paid or payment amount based on deliverables.
- **NINETEEN OF THE 22 SAMPLED CONTRACTS WERE MISSING FEDERALLY REQUIRED PROVISIONS.** These 19 contracts with vendors did not contain one or more provisions required by OMB *Circular A-110*. Specifically, one \$184,675 contract for IT services did not contain provisions for breaches of contract and termination; four contracts for IT services, outreach services, and consulting totaling \$1,407,552 did not contain the provision to allow for audits of the vendors, such as by providing Connect for Health access to the vendor’s records; and 19 contracts did not contain the required equal employment opportunity clause.

WHY DID THESE PROBLEMS OCCUR?

Overall, Connect for Health has not established sufficient policies and procedures to ensure that all payments to contractors comply with contract terms, that the Board approves contracts of \$150,000 or more, and that contracts contain all provisions required by federal

regulations. Specifically, the problems we identified occurred for the following reasons:

- **INSUFFICIENT MONITORING OF CONTRACT PAYMENTS.** Connect for Health does not have adequate policies or procedures for monitoring payments to ensure that contractors' performance complies with their contracts, and payments do not exceed the total contract amounts. For example, Connect for Health does not have a policy, procedure, or guideline requiring contractors to submit documentation supporting each payment request and the services provided, such as itemized invoices, timesheets, travel itineraries, and training attendance logs. Management represented that the contract tracking spreadsheet that it provided for our review during the audit was a complete list of contracts and contract amounts when it provided the list, but following our review reported that staff's tracking of contracts in this list was inaccurate and incomplete. Staff also allowed some vendors to bill Connect for Health for services after their contracts had expired, without support for the amounts billed and without new contracts.
- **LACK OF CONSISTENT AND COMPLETE PROCUREMENT AND CONTRACTING POLICIES AND PROCEDURES.** Connect for Health has separate policies for procurement depending on whether or not the vendor is a consultant, which could cause some confusion among staff. Connect for Health's Consultant Policy specifies that contracts with vendors who are considered consultants must be approved by the Board's Finance Committee if the contract is \$150,000 or more annually, while its Procurement Policy more generally states that Board approval is required for procurements of \$150,000 or more without specifying a timeframe or type of vendor. During the audit, Connect for Health staff were not able to identify which vendors were consultants and which policy applied to the different vendors.

Connect for Health's procurement policies do not provide sufficient guidance to ensure that the Board approves contracts and expenditures that are more than \$150,000. Procurement policies state that expenditures over \$150,000 must have Board approval. However, based on our review of Board minutes and interviews with Connect

for Health staff, in practice, the Board authorized the Executive Director to negotiate contracts on behalf of Connect for Health but did not ensure that the Executive Director obtained Board approval for the final contract amounts or reported the final contract amounts to the Board. The policies also do not state whether the staff should obtain Board approval in instances when contracts are initially below \$150,000 but payments to the contractor exceed that amount. Connect for Health staff reported that when the initial contract amount is less than \$150,000 but the payments exceed that amount, staff believed that they did not need to notify the Board or obtain Board approval.

Further, Connect for Health executes contracts for small purchases because it has not set a minimum dollar threshold needed to execute a contract, such as a \$5,000 minimum. None of Connect for Health's policies or procedures specify a minimum threshold which can create an unnecessary administrative burden when executing contracts for small purchases.

- **INCONSISTENT USE OF CONTRACT TEMPLATES.** Connect for Health did not always use a standard contract template that included the federally required provisions and did not have an effective review process to ensure all contracts were complete before they were executed. Connect for Health used different contract templates, including those prepared by vendors, which did not always include the provisions required by *Circular A-110*.

WHY DO THESE PROBLEMS MATTER?

Connect for Health is responsible for ensuring federal funds are used properly for the establishment and continued operation of the health exchange in Colorado. When Connect for Health pays for services without contracts and uses contracts with missing provisions, it lacks mechanisms to hold vendors accountable for contract performance and risks making improper payments. When the organization pays contractors more than the amounts allowed in the contracts without

sufficient Board oversight, the contracts do not serve as a control over finances and spending.

Further, it is important for the Board to know how much will be spent on each major contract in order to monitor actual expenditures and ensure Connect for Health can be self-sustaining. When the Board does not receive complete information on vendor contracts, it is difficult for members to oversee Connect for Health's major financial obligations to ensure that funds are used properly.

CLASSIFICATION OF FINDING: SIGNIFICANT DEFICIENCY

RECOMMENDATION 2

Connect for Health Colorado should improve its controls over payments to contractors and contract administration by:

- A Establishing a comprehensive written procurement policy or procedure that specifies the Board of Directors' (Board's) responsibilities for contract approval. This should include establishing an appropriate minimum threshold for executing contracts, implementing a consistent Board-approval procedure for all contracts of \$150,000 or more, and establishing reporting and approval procedures for payments that exceed the amount that was approved by the Board.
- B Establishing and implementing procedures and processes to accurately track each contract and monitor payments to vendors to ensure that payments do not begin before the contract is fully executed and do not exceed contract amounts without appropriate Board and management approval, an executed addendum to the contract statement of work, and documentation of the services provided.
- C Consistently utilizing contract templates that include federally required provisions and developing and implementing written procedures to review all contracts for completeness before they are executed. This should include ensuring contracts contain all required provisions, are signed by authorized management, and specify statements of work, periods of performance, and payment terms.
- D Establishing and implementing written procedures to ensure that complete information about contracts exceeding the approval thresholds is provided to the Board and documented in Board minutes. This should include a process to ensure Board approvals are documented.
- E Training management, staff, and Board members, as appropriate, on the policies, procedures, and processes developed in recommendation PARTS A through D.

RESPONSE

CONNECT FOR HEALTH COLORADO

A AGREE. IMPLEMENTATION DATE: JANUARY 2015.

To obtain federal grants in 2012, Connect for Health Colorado was required to have in place federally approved procurement policies and procedures. Connect for Health agrees with the audit findings and will establish a more comprehensive written procurement policy and applicable procedures that specify the Board's responsibilities for contract approval. This will include establishing an appropriate minimum threshold for executing contracts, implementing a consistent Board-approval procedure for all contracts of \$150,000 or more, and establishing reporting and approval procedures for payments that exceed the contract amount approved by the Board.

In October 2014, Connect for Health began updating procurement policies to include a more robust process in conjunction with the executive management team, members of the Board's Finance Committee, and the Board with respect to procurement and independent contractor management, including: (i) an appropriate minimum threshold for executing contracts; (ii) consistent Board-approval procedure for all contracts with a specified threshold; and (iii) reporting and approval procedures for payments that exceed thresholds approved by the Board. The procedures will address multiple individual "statements of work" from a single vendor below any applicable approval threshold that may cumulatively exceed the threshold over time so as to clarify the circumstances when additional Board approval will be required. These updated policies will be presented to the Finance Committee and Board of Directors in January 2015 for approval before final implementation.

B AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado agrees with the audit findings regarding the accurate tracking of contract amounts, terms, and payments. The Controller, Assistant Controller, and Accounts Payable Specialist were trained in October on Intacct's tools and workflow processes to track vendor contracts through the Purchase Order and Project Modules. A customized report will be finalized by the end of December that will

show contract amount, term, spent to date, and balance. Work on this report will begin in November and will be tested and audited to ensure accuracy. This report will be monitored monthly by the Controller and Accounts Payable Specialist.

With the implementation of these accounting tools, Connect for Health will establish and implement procedures and processes to document this. These procedures will include how to accurately track each contract; monitor payments to vendors to ensure appropriate timing of payments; and ensure that payments do not exceed contract amounts without appropriate Board and management approval, an executed addendum to the contract statement of work, and documentation of the services provided. Oversight and management of vendor relationships by General Counsel and legal staff will ensure that each contract contains all the appropriate language, that appropriate Board and executive level approval exists, and that the terms and conditions lay out all appropriate, required, and prudent contract terms.

C AGREE. IMPLEMENTATION DATE: JANUARY 2015.

Connect for Health Colorado will consistently utilize contract templates that include federally required provisions and develop and implement written procedures to review all contracts for completeness before they are executed. This will include ensuring contracts contain all required provisions, are signed by authorized management, and specify statements of work, periods of performance, and payment terms.

As noted in Recommendation 2, Part B, General Counsel will oversee and monitor all contractual procedures. The addition of General Counsel will help ensure that the template is used for all contracts, and that written procedures are updated as needed. This will include ensuring contracts contain all required provisions, are executed by an individual with the authority to bind the organization, and contain all appropriate, required, and prudent terms and conditions.

D AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado agrees with the audit findings regarding the need for documentation of Board decisions. In combination with the revision of the procurement policies detailed in Recommendation

2, Part A, and the implementation of the finance tools and reports detailed in Recommendation 2, Part B, Connect for Health will take steps to document all Board decisions as well. The steps that are being taken to accomplish this documentation are:

- Improving an existing spreadsheet document that memorializes action items from previous Board meetings and policy decisions to include vendor name, contract amount, contract terms, and Board votes (including unanimous votes and Yes/No vote counts), and
- Enlisting staff to capture historical decisions in this spreadsheet by researching Board meeting documentation on file.

Connect for Health Colorado will establish and implement written procedures to ensure that complete information about contracts exceeding the approval thresholds is provided to the Board and documented in Board minutes. This will include a procedure detailing the Board documentation process detailed above.

E AGREE. IMPLEMENTATION DATE: JUNE 2015.

Connect for Health Colorado will train management, staff, and Board members, as appropriate, on the new or improved policies, procedures, and processes developed in Recommendation 2, Parts A through D.

GRANTEE PAYMENTS AND REIMBURSEMENTS

Federal regulations require state-run health exchanges to conduct consumer assistance and public education [45 CFR 155.205 and 155.210], and the federal Department of Health and Human Services has authorized states to use federal funds for these purposes. Connect for Health has established a grant program called the Assistance Network Program, to award federal funds to organizations to provide in-person customer assistance with enrolling in health plans and public education. The grantees conduct public education activities to raise awareness about Connect for Health; provide consumers information about health insurance plans, premium tax credits, Medicaid, and the Children's Health Insurance Program or CHIP; facilitate consumers' enrollment in health plans; and answer consumers' questions.

In July 2013, Connect for Health used about \$12 million of its federal funds to award Assistance Network Program grants to 46 organizations that were primarily non-profits and local county health departments. The Board approved each organization to receive one grant and the awards ranged from \$25,100 to \$816,100. Connect for Health executed contracts with each grantee to provide services for 18 months, from July 2013 through December 2014. According to Connect for Health, it typically reimburses grantees for their costs, although some grantees receive advance payments to cover future costs. As of May 2014, Connect for Health had paid the grantees about \$4.5 million.

In addition to the Assistance Network Grant Program, Connect for Health administers a separate Navigator Grant Program that provides grants to organizations that also provide consumer assistance similar to the Assistance Network Grant Program, including raising public awareness of the services provided by the organization and helping consumers enroll in health plans. However, Navigator grantees are not

required to provide in-person assistance. Connect for Health received a \$2 million grant from the Colorado Health Foundation to administer the Navigator Grant Program because federal regulations [45 CFR 155.210(f)] do not allow federal funds to be used for navigator services.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of our audit work was to determine whether Connect for Health has sufficient controls over its use of federal funds for the grants it awards and adequate processes to oversee reimbursements and payments to grantees to ensure compliance with federal laws and regulations, the grant contracts, and Connect for Health written policies and procedures. We did not evaluate Connect for Health's processes for selecting or monitoring grantees nor did we assess grantee performance because we did not have the statutory authority to review those processes.

We reviewed a sample of 26 transactions and payments totaling \$567,700 for 10 grantees recorded during Fiscal Year 2014 to determine whether the payments were allowable, reasonable, appropriate, and recorded accurately by Connect for Health. For each sampled transaction, we reviewed Connect for Health's electronic general ledger data and its documentation, such as invoices, receipts, grant contracts, cancelled checks, bank account statements, check reconciliation documentation, grantee timesheets, CMS reports, Board minutes, and email correspondence between grantees and Connect for Health staff. Our audit work primarily focused on the Assistance Network Grant Program because Connect for Health management represented to us that it used federal funds to pay those grantees. We also reviewed whether Connect for Health had complied with federal regulations when paying the Navigator Grant Program grantees. Additionally, we interviewed Board members, management, and staff to understand Connect for Health's processes for reviewing and approving grantees' reimbursements and advance payment requests.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

As the administrator of two grant programs that have awarded approximately \$14 million in grants to grantees, Connect for Health should have sufficient processes and controls over these awarded funds. We applied the following criteria to assess Connect for Health's controls over reimbursements and payments to its grantees:

- **SERVICES, GOODS, AND ASSOCIATED PAYMENTS MUST BE ALLOWABLE, NECESSARY, REASONABLE, AND ADEQUATELY DOCUMENTED.** Connect for Health's Assistance Network Grant Program is authorized by federal regulations [45 CFR 155.205(d) and (e)] to provide in-person assistance, outreach, and education to consumers so that they can receive help when accessing health insurance coverage through an exchange. State exchanges may use federal grants to fund this type of in-person assistance program. However, federal regulations [45 CFR 155.210(f)] specifically prohibit state-run health exchanges from using federal funds for their Navigator Program services and activities; using federal funds for these costs is unallowable.

Further, the federal Office of Management and Budget's (OMB) *Circular A-122, Cost Principles for Non-Profit Organizations (Circular A-122)*, guidelines for allowable costs state that all costs charged to a federal award, which includes payments that Connect for Health makes to grantees through its grant program, must be necessary, reasonable, and adequately documented. *Circular A-122* states that the reasonableness of specific costs must be scrutinized with particular care for organizations that receive most of their funding from federal awards. *Circular A-122* defines a reasonable cost as one that, in its nature or amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs; the cost should also be generally recognized as ordinary and necessary, such as those normal for the organization to incur.

- **RECIPIENTS OF FEDERAL FUNDS MUST HAVE SYSTEMS OF INTERNAL CONTROLS OVER FINANCIAL TRANSACTIONS AND LIMITATIONS ON ADVANCE PAYMENTS.** OMB *Circular A-110, Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations (Circular A-110)* outlines standards for financial management systems and payment methods for recipients of federal funds, including Connect for Health. Specifically, Connect for Health must maintain accounting records that are supported by source documentation [Section 215.21(b)(7)]. Connect for Health must also limit advance payments to grantees to the minimum amounts needed and ensure the advance payments are made only when the subrecipient organization has an actual, immediate cash requirement in order to carry out the purpose of the approved project. *Circular A-110* states that advance payments should be close to the actual costs incurred [Section 215.22(b)(2)].

The federal HHS Grants Policy Statement provides guidance for the administration of grants. The Grants Policy Statement requires recipients of federal funds, including Connect for Health, to maintain records that adequately identify the sources of funds used to pay for federally assisted activities and the purposes for which the funds were used, to help ensure federal funds are used for the appropriate activities. The Grants Policy Statement also requires Connect for Health to maintain documentation of authorizations, obligations, assets, liabilities, expenditures, and program income and source documentation to support payments such as canceled checks, paid bills, payrolls, and time and attendance records.

- **INTERNAL WRITTEN PROCEDURES FOR GRANT PAYMENTS REQUIRE STAFF TO REVIEW GRANTEE DOCUMENTATION.** Connect for Health's written procedures specify that, when staff review grantee payment requests, the staff must: (1) ensure that only authorized grantee employees are included in the grantee's budget; (2) match grantee supporting documentation, such as timesheets, to the grant budget and the grantee's payment requests, to ensure requested amounts match the allowable expenditures under the grant; (3) verify that grantee employees are paid the correct amount for the work performed; and

(4) return documents to the grantee if there is an error in the grantees' payment request so that the grantee may submit a corrected payment request. The procedures also state that "...advance disbursements are used only for immediate needs" and that grantees must submit documentation showing how the advance funds were spent within 60 days of the request. Additionally, Connect for Health's written Financial Procedures state that all invoices are paid weekly, or as required by special circumstances, and the CFO or Controller reviews all invoices and verifies goods or services were received.

- **CONNECT FOR HEALTH GRANT CONTRACTS SPECIFY GRANT REQUIREMENTS INCLUDING SUPPORTING DOCUMENTATION FOR PAYMENT REQUESTS.** Connect for Health's grant contracts with its grantees specify that the Assistance Network Grant Program pays grantees by direct reimbursement, meaning that each month grantees should request reimbursement for costs incurred on their grant projects. However, the grant contracts state that a grantee may request an advance payment of grant funds for expenses that it expects to incur in the month following the advance payment request. Connect for Health's grant contracts require all grantees to submit documentation such as invoices, timesheets, and receipts along with payment requests. Connect for Health's grant contracts also include budgets that specify the amounts that grantees may spend in each budget category, such as personnel costs, benefits, supplies, subcontracts, and administrative costs.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

We identified one or more problems with 10 of the 26 grantee transactions (38 percent) that we sampled. We also found problems with Connect for Health's use of federal funds to pay six grantees that were outside of the sample. Overall, we found that Connect for Health paid some grantees federal funds for unallowable services; reimbursed grantees without evidence to support the services provided or the payment amounts; and paid some grantees based on miscalculated

payment requests, in an untimely manner, and without supervisory review. These problems with payments to grantees totaled \$590,000 and resulted in \$84,905 in questioned costs because of noncompliance with federal requirements. The problems we identified are described below.

- **SEVEN GRANTEEES THAT PROVIDED NAVIGATOR SERVICES WERE PAID \$432,809 IN FEDERAL FUNDS, WHICH VIOLATED FEDERAL REGULATIONS.** When reviewing the sampled payments to grantees we found that Connect for Health paid one of its Navigator grantees a total of \$57,863 in federal funds during January and February 2014, in violation of federal regulations [45 CFR 155.210(f)]. Management confirmed that this grantee should have been paid with private funds from the Colorado Health Foundation.

Upon further review of Connect for Health's general ledger, we found that Connect for Health had paid seven Navigator grantees, including the sampled grantee above, a total of \$432,809 in federal funds when the grantees should have been paid with private funds. Specifically, the seven grantees were paid in federal grant funds between September 2013 and April 2014, which violated federal regulations. In October 2014, Connect for Health management provided documentation showing it corrected the problem with these payments by reducing a reimbursement request submitted to CMS to repay the federal funds and by revising its general ledger to note that the grantees were paid with private funds. Because Connect for Health repaid CMS the \$432,809 in federal funds, these improper payments are not considered questioned costs.

- **SIX SAMPLED GRANTEEES WERE PAID A TOTAL OF \$16,162 WITHOUT EVIDENCE TO SUPPORT THE COSTS.** Specifically, we found:
 - ▶ Three grantees were paid \$15,206, \$217, and \$34, respectively, for the cost of work done by six individuals but Connect for Health did not have evidence that the individuals actually worked on Connect for Health grants at the time it paid the grantees, which was out of compliance with *Circular A-122*. In addition, the \$15,206 payment to

one grantee included an overpayment of \$560 because the grantee had miscalculated one staff's salary and Connect for Health did not identify this error. This \$15,457 is questioned costs.

- ▶ Another grantee was paid \$250 for overtime for two employees, but the timesheets that Connect for Health received from the grantee showed that the employees had not worked any overtime. Connect for Health management reported to us that it believed it was necessary to pay the amount that was not supported by the timesheets because it covered items, such as staff meetings, that were not related to the Connect for Health grant. Staff also stated that if a grantee submits a budget showing that its staff will spend all of their time on the Connect for Health grant, Connect for Health will pay the full amount that the grantee requests for salaries even if the timesheets do not support the requested salary amount. Paying a grantee for a cost that is not related to the Connect for Health grant and not supported by the documentation violates *Circular A-122* and Connect for Health's written procedures requiring documentation such as timesheets to support the grantees' payment requests. This \$250 is questioned costs.
- ▶ Two other grantees were paid \$380 and \$75, respectively, for expenses noted as "other" on the grantees' reimbursement requests but did not provide documentation or explanations supporting those amounts. According to Connect for Health staff, they had noted that the \$380 request lacked supporting documentation but erroneously paid this amount. For the \$75 payment, Connect for Health staff stated that they planned to contact the grantee to request supporting documentation. These problems resulted in \$455 in questioned costs.
- **CALCULATION ERRORS RESULTED IN \$7,140 IN OVERPAYMENTS TO THREE SAMPLED GRANTEEES.** Specifically, we found:
 - ▶ One grantee was overpaid \$3,872 for expenses that appeared to be duplicated on the grantee's supporting documentation. This grantee was paid \$1,449 for administrative expenses after it was paid \$2,007 for what appeared to be the same expenses, and it was paid \$2,423 for administrative costs after being paid \$2,196 for what appeared to be

the same costs. This second payment included an overpayment of \$290 because Connect for Health staff had miscalculated the grantee's administrative costs. Connect for Health staff reported that they planned to follow up with this grantee because staff were unsure whether the costs we identified had been duplicated. This \$3,872 is questioned costs.

- ▶ Two grantees were overpaid \$3,212 and \$56, respectively, because the grantees miscalculated their personnel expenses, including employees' salaries and benefits, on their payment requests. This \$3,268 is questioned costs.
- **THREE SAMPLED GRANTEEES WERE GIVEN ADVANCE PAYMENTS BEFORE PROVIDING SERVICES, WITHOUT DEMONSTRATING AN IMMEDIATE NEED FOR THE ADVANCES.** Connect for Health did not require these sampled grantees to demonstrate that they had an immediate need for advance payments, as required by *Circular A-110*. In fact, for the sampled payments we reviewed, the grantees provided Connect for Health documentation showing that their actual expenses were less than the advance payments that they had requested and Connect for Health had paid. Specifically, one grantee received a \$76,942 advance payment but submitted documentation showing that it had needed and spent only \$23,306, resulting in an overpayment of \$53,636; Connect for Health paid this grantee eight other advances totaling \$223,613 between July 2013 and May 2014. The second grantee received an advance of \$15,300 but submitted documentation showing that it had needed and spent only \$10,351, resulting in an overpayment of \$4,949. The third grantee received an advance of \$6,131 but submitted documentation showing that it had needed and spent only \$4,366, resulting in an overpayment of \$1,765.

According to Connect for Health staff, grantees that did not spend the full amount of their advance payments were allowed to keep the funds and apply the balance to the following month's expenses. However, based on Connect for Health's documentation for these three sampled grantees, we could not determine whether the unspent funds were applied to the grantees' reimbursements in subsequent months. After

discussing these problems with Connect for Health, staff stated that these three grantees submitted documentation in September 2014 that showed the grantees had spent all of the advance funds they had received and Connect for Health informed one of the grantees that it would not receive future advanced payments due to the problems identified. These problems resulted in \$60,350 in questioned costs.

- **TWO SAMPLED GRANTEEES WERE PAID A TOTAL OF \$1,153 FOR ITEMS THAT WERE NOT APPROVED IN THE GRANTEEES' GRANT CONTRACT BUDGETS.** These problems included one \$973 payment for advertising and mailing expenses, two payments totaling \$100 for travel expenses, and two payments totaling \$80 for food expenses that were not approved by the grantees' contract budgets. Although internal written procedures state that staff are required to match the grantee's payment request supporting documentation to the grantee's grant budget, Connect for Health reimbursed these grantees costs that exceeded the contract budget amounts. This \$1,153 is questioned costs.
- **TWO SAMPLED GRANTEEES WERE REIMBURSED FUNDS IN EXCESS OF THE AMOUNTS SPECIFIED IN THEIR GRANT CONTRACTS.** These reimbursements included one \$76 overpayment to a grantee for per diem expenses, and one overpayment of \$24 to a grantee because Connect for Health reimbursed for the actual cost of a benefit rather than 10 percent of the employee's salary, as required in the grant contract budget. These problems resulted in \$100 in questioned costs.
- **UNTIMELY REIMBURSEMENTS TO GRANTEEES.** Some payments to grantees were not processed in a timely manner according to Connect for Health's procedures. We identified delays in payments to grantees for up to 4 months between November 2013 and February 2014. Additionally, for one grantee in our sample who submitted a reimbursement request in November 2013, staff paid the grantee in February 2014 and incorrectly recorded the payment in the general ledger as an "advance payment" rather than as an expense.

- **LACK OF MANAGEMENT’S SUPERVISORY REVIEW FOR ONE SAMPLED GRANTEE PAYMENT.** We identified one advance payment of \$34,263 to one sampled grantee that was not reviewed by the CFO or Controller.

During the audit, Connect for Health management reported to us that for some of the payment errors we identified, it planned to follow up with the grantees to request supporting documentation and if not provided, reduce subsequent payments to grantees based on the payment problems that we identified. For some of the errors we identified, Connect for Health management reported that it believed the payments were necessary or appropriate.

WHY DID THESE PROBLEMS OCCUR?

Overall, Connect for Health has not implemented adequate controls and oversight over reimbursements and payments to grantees. We identified the following reasons for the problems we found:

- **STAFF DID NOT FOLLOW ESTABLISHED PROCEDURES.** Staff did not consistently follow Connect for Health’s written procedures requiring them to review grantee supporting documentation, compare that documentation to the grantee’s contract budget to ensure the funds requested were allowable, verify that grantee employees were paid the correct amount for the work performed, and return requests to the grantees when there were errors. Management reported to us that the organization paid some grantees without reviewing the grantees’ documentation and paid grantees without correcting errors because of a high volume of grantee payment requests and staff were behind in processing payments. For the grantee that requested reimbursement in November 2013 but was paid in February 2014, management reported that staff recorded the payment as an advance when it was not an advance because the grant accountant had not reviewed the reimbursement request documentation in a timely manner.
- **POLICIES, PROCEDURES, AND CONTROLS ARE NOT SUFFICIENT TO ENSURE PAYMENTS TO GRANTEEES ARE REASONABLE AND APPROPRIATE.** Connect for Health does not have comprehensive policies or procedures for

managing and overseeing the grants it awards, so staff do not have adequate guidance on administering grants. The written policies and procedures do not prohibit staff from paying Navigator Program grantees with federal funds or require staff to ensure that the source of funds used to pay these grantees is accurate. At the time of our testwork, the policies and procedures did not outline the types of documentation that grantees were required to submit to support their reimbursement requests, and did not provide staff guidance on reviewing grantee payment request documents. In addition, although Connect for Health's Financial Procedures indicate that management should ensure payment requests are paid weekly, Connect for Health's grant procedures do not specify reasonable timeframes for staff to review grantee documentation and process payments to grantees.

Further, Connect for Health's policies and procedures do not require grantees who request advance payments to submit documentation demonstrating they have an immediate need before they are paid. Connect for Health requires grantees that have received advance payments to provide documentation showing how they spent the funds within 60 days of payment; however, Connect for Health does not have sufficient processes to determine whether grantees spent all of the advanced funds within this time because it allows grantees to request multiple advances in consecutive months.

In September 2014, Connect for Health provided the audit team revised policies and procedures that require staff to compare supporting documentation, such as mileage logs, invoices, and receipts to the grantees' expenses, and to validate that the payment request agrees with the grantees' documentation. However, the revised policies and procedures do not address many of the problems we identified with payments and reimbursements to grantees. For example, the revised policies and procedures do not address the problems we found with Connect for Health paying Navigator grantees federal funds, overpaying grantees based on miscalculations, providing grantees advance payments without a demonstrated need for the advances, and untimely processing of grantee payment requests.

- **CONNECT FOR HEALTH USED FEDERAL FUNDS RATHER THAN PRIVATE FUNDS TO PAY SOME GRANTEES IN ORDER TO PROCESS THE PAYMENTS QUICKLY.** Connect for Health staff reported to us that staff were told to charge the Navigator grantees' costs to the federal grant between September 2013 and April 2014 and correct the transactions later in order to process these payments quickly. However, Connect for Health received its private grant from the Colorado Health Foundation in September 2013 so private funds were available to pay these grantees, and incorrectly using federal funds for these costs did not create efficiencies.

- **STAFFING AND SUPERVISION WAS NOT SUFFICIENT TO ENSURE EFFECTIVE GRANTS MANAGEMENT.** During our review, Connect for Health had one staff member, a grant accountant, responsible for all grants management including reviewing all grantee reimbursement and advance payment requests. According to Connect for Health staff, the grant accountant could not keep up with the large volume of grantee payment requests, which caused delays in paying the grantees' requests for up to 4 months between November 2013 and February 2014. During this time, Connect for Health did not have a Controller, who was the supervisor responsible for overseeing the grant accountant. The supervisory review process did not appear sufficient to identify calculation errors or noncompliance with federal and internal requirements. The payment delays were not discovered until February 2014 when a new Controller was hired, indicating that management had not been adequately overseeing grantee payments.

WHY DO THESE PROBLEMS MATTER?

Connect for Health has a responsibility to ensure that public funds used for its grant programs are expended to help consumers enroll in health plans and that its grantees are using funds only for grant purposes and in compliance with federal requirements. When staff pay federal funds to grantees who should not receive them, it violates federal regulations and increases the staff time needed to process and record the transactions. Connect for Health's process for making these

improper payments was inefficient—staff recorded the unallowable costs to the federal grant, obtained federal funds to cover the costs, corrected how the transactions were recorded in the general ledger to draw private funds rather than federal funds, and then reduced a subsequent reimbursement request to CMS to return the improperly used funds.

When staff pay grantees without supporting documentation or without correcting errors, Connect for Health cannot adequately ensure that federal funds are being spent appropriately and that the grant program is fulfilling its purpose under the Affordable Care Act to provide consumer assistance. Additionally, when Connect for Health makes advance payments to grantees without evidence of immediate need, as required by *Circular A-110*, it creates a risk that grantees will misuse funds without providing Connect for Health sufficient services. While paying advances is generally allowable under *Circular A-110*, they increase the administrative burden and staff time needed to track the funds paid in advance to grantees and ensure that grantees provide documentation supporting that the funds are needed and spent appropriately. Paying advances also increases the risk that grantees will receive more funds than they will need in the future for Connect for Health grant projects.

CLASSIFICATION OF FINDING: SIGNIFICANT DEFICIENCY

RECOMMENDATION 3

Connect for Health Colorado should ensure reimbursements and payments to grantees are reasonable, necessary, accurate, and allowable in accordance with federal laws and regulations, internal policies and procedures, and grant contracts by:

- A Establishing and implementing comprehensive written policies and procedures to administer its grant program. This should include written policies and/or procedures that prohibit the organization from obtaining or using federal funds for any grantees that federal requirements prohibit from receiving federal funds; ensure grantees are paid in compliance with their contract terms and the documentation supporting grantees' actual costs; and ensure timely payment processing.
- B Establishing and implementing processes to oversee the grant program, including ensuring that there are adequate staff to review and process payment requests in a timely manner; ensuring staff review documentation supporting grantee payment requests and correct errors prior to payment; implementing consistent supervisory reviews of transactions before grantees are paid; and accurately recording all transactions in the general ledger.
- C Evaluating the practice of making advance payments to grantees before services are provided. If this practice continues, Connect for Health should develop a written policy and/or procedure requiring grantees to submit documentation demonstrating an immediate need before making advance payments grantees; an appropriate supervisory review of all advance payments for reasonableness, appropriateness, and federal compliance; and a reconciliation to ensure grantees spend all advances before receiving subsequent advances.
- D Investigating each instance of overpayment, noncompliance, and error identified in the audit and recover funds from grantees, as appropriate.

RESPONSE

CONNECT FOR HEALTH COLORADO

A AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado will establish additional written policies and procedures to administer its grant program. This will include policies and/or procedures that control the use of federal funds for grantees; ensure grantees are paid in compliance with their contract terms and the documentation supporting grantees' actual costs; and ensure timely payment processing. Connect for Health will implement written policies and procedures regarding the administration of its grant program.

B AGREE. IMPLEMENTATION DATE: DECEMBER 2014.

Connect for Health Colorado will review and update written policies and procedures regarding the administration of its grant program, which was approved and monitored by the federal government under its grant award. In May of 2014, Connect for Health hired new staff and began implementing additional procedures to ensure that there are adequate staff to review and process payment requests in a timely manner; ensure staff review documentation supporting grantee payment requests and correct errors prior to payment; implement consistent supervisory review of transactions before grantees are paid; and accurately record all transactions in the general ledger.

These procedures, which include review by Connect for Health's Controller prior to the disbursement of funds, has helped ensure that grantees are paid in compliance with their contract terms and the documentation supporting costs has been received. The procedures further ensure timely payment processing. Grantees have not experienced delays in reimbursement payment since July 2014. Requests for reimbursement now contain appropriate and adequate documentation, and reimbursement is being made from appropriate funding sources.

C AGREE. IMPLEMENTATION DATE: MARCH 2015.

Over the past 3 months, Connect for Health Colorado has been able to improve internal processes to ensure timely payment of grantees reimbursement requests. Management and staff have worked with grantees who were not consistently providing the appropriate documentation after being awarded an advance payment. Those grantees who have not been able to improve have been changed to a reimbursement only status, and no future advances are paid.

In July 2014, Connect for Health communicated with the Centers for Medicare and Medicaid Services to confirm advance payment processes to grantees as permitted under Level 2 Grant funding. Connect for Health received confirmation that advances are anticipated with appropriate documentation to support the need for the requested advance. Internally, Connect for Health now has tracking tools to ensure that grantees who are awarded advances submit their previous month's reimbursement documentation, and that the outstanding advanced monies are not more than they have historically shown a need for on a monthly basis. If the balance in a grantee's advance account is greater than historical monthly need, the advance is being denied and the organization is notified to determine how to proceed. Additionally, improved internal processes and the hiring of staff reduced the payment time for reimbursement requests, thus reducing the number of grantees requesting advances as follows:

- February 2014 – 11 grantees requested advances of \$379,487.
- March 2014 – 9 grantees requested advances of \$334,690.
- April 2014 – 8 grantees requested advances of \$221,979.
- September 2014 – 3 grantees requested advances of \$59,480 but only 2 grantees received advances.

The grantees who were still requesting advances in September have been notified of the controls implemented by Connect for Health, and were queried as to whether they would be able to continue exchange activity without advances in the future. Two of the three indicated that this amount is still necessary. The third grantee has been converted to a reimbursement-only payment type.

D AGREE. IMPLEMENTATION DATE: MARCH 2015.

Connect for Health Colorado agrees with the findings of the state audit that constant vigilance is needed to investigate and identify any

instance of overpayment, noncompliance, and error. Connect for Health's internal review processes were strengthened in February, when it hired a Controller (filling a vacancy), and continued in full force in May, when new grant accounting staff was hired.

Moving forward, for any organization where an overpayment, noncompliance indicating an overpayment, or errors were identified, the under or overpayment amounts and instances will be reviewed and addressed by the Controller. Meetings will be scheduled with grantee organizations to discuss the results of any review or investigation. Reimbursements requested by an organization will be reduced or increased as appropriate. This review and adjustment process will be ongoing and continue through the grantee award cycle as appropriate. The intent of this process is to ensure that federal funds are tracked and maintained pursuant to all applicable regulatory authority.

FINANCIAL ADMINISTRATION AND MANAGEMENT

Sound financial management is a fundamental responsibility of any organization, especially entities primarily funded with public funds or providing a public service on behalf of the government.

The federal government has awarded Connect for Health \$177.7 million in federal grants for the development and implementation of the health exchange since its inception in 2012. As of September 13, 2014, Connect for Health had spent \$136.5 million in federal funds. Connect for Health's executive management administers financial activities by executing contracts with vendors, reviewing and approving payments to vendors, preparing and reviewing financial statements and the annual budget, and presenting financial information to Connect for Health's Board of Directors (Board). The Board oversees financial management practices by approving the annual budget and some vendor and grantee contracts, and reviewing financial statements and other financial information that are presented by management.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of the audit work was to review Connect for Health's processes and systems for managing the federal funds it receives and to determine whether the organization operates efficiently and in compliance with applicable federal regulations, state laws, and organizational policies and procedures.

As discussed in the previous section of this report, our audit work included reviews of 66 sampled payments to vendors totaling about \$9.71 million, total payments made to a sample of 53 vendors, 22 sampled contracts, and 26 sampled payments to 10 grantees totaling about \$567,700.

We also reviewed Connect for Health's financial statements, financial audit reports for Fiscal Years 2012 and 2013, bank account statements and reconciliation documentation, and reimbursement data from the Centers for Medicare and Medicaid (CMS), the federal agency that oversees and administers grants to state health exchanges, including Connect for Health. We compared the statements of activities for a sample of three months during Fiscal Year 2014 to the information recorded in the general ledger for those months. We reviewed Connect for Health's policies and procedures and state statutes to determine the Board's responsibilities for overseeing the organization's financial activities and monies received. In addition, we interviewed management and staff with fiscal and accounting responsibilities, and Board members to understand Connect for Health's overall system of financial controls and practices for overseeing expenditures.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Overall, Connect for Health's Board and executive management are responsible for developing a system of financial management practices and internal controls which ensures that the organization complies with laws and regulations, and expends funds prudently and effectively to optimize available resources. We used the following criteria to assess Connect for Health's management and oversight of federal funds and its financial internal controls:

- **CONNECT FOR HEALTH SHOULD HAVE SUFFICIENT FINANCIAL MANAGEMENT SYSTEMS.** The federal Office of Management and Budget's (OMB) *Circular A-110* requires recipients of federal funds to

have financial management systems that provide for the effective control over and accountability for all funds. Financial records must identify the source and use of funds and contain accurate, current, and complete financial information. In addition, *Circular A-110* states that recipients of federal grants, including Connect for Health, must have written procedures for determining the reasonableness and allowability of costs under the federal award [Section 215.21(b)(6)]. In addition, Connect for Health’s written procedures state that all financial records are maintained in accordance with federal and state guidance, generally accepted accounting principles (GAAP), and financial accounting standards board (FASB).

- **CONNECT FOR HEALTH SHOULD HAVE AN EFFECTIVE SYSTEM OF INTERNAL CONTROLS.** The federal Department of Health and Human Services (HHS), which provides grants to states to establish state health exchanges, requires Connect for Health to maintain adequate financial controls. Specifically, the HHS Grants Policy Statement requires recipients of federal grants to maintain accounting records that adequately identify the sources of funds and the purposes the funds were used, document authorizations, and ensure accounting records are supported by source documentation.

The Internal Control–Integrated Framework, or COSO Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is the leading guidance for designing, executing, and assessing effective financial internal controls in organizations. An internal control is a process designed to provide reasonable assurance that the organization will achieve operational, reporting, and compliance objectives. For example, the COSO Framework states that an organization’s system of internal controls should include: (1) standards, processes, and organizational structures that provide the basis for carrying out controls across the organization; (2) policies and procedures that help ensure management’s directives to mitigate risk are carried out; (3) the use of quality information to support internal controls; and (4) ongoing risk-based monitoring to assess whether internal controls are present and functioning. The COSO Framework also notes the importance of

segregation of financial duties so that one person is not responsible for recording, authorizing, and approving transactions.

According to the COSO Framework, management, the board of directors, and personnel are responsible for ensuring effective internal controls. Specifically, the chief executive officer sets the “tone at the top” that affects integrity and ethics of the organization and is ultimately responsible for the system of internal controls; the board of directors provides guidance and oversight of financial activities and the control environment, and should help identify and correct weaknesses in internal controls; and personnel carry out controls, policies, and procedures on a day-to-day basis.

- **THE BOARD MUST OVERSEE CONNECT FOR HEALTH’S OPERATIONS AND FINANCES.** Statute (Section 10-22-104, C.R.S.) states that the Board shall govern the operation of and establish the development, governance, and operation of the exchange. Statute also states that the Board must ensure the operational well-being and fiscal solvency of the exchange [Section 10-22-105(2), C.R.S.] and the Board shall create technical and advisory groups to implement and oversee the exchange [Section 10-22-106(1)(d), C.R.S.]. Connect for Health’s written policies require the Board to approve proposed expenditures over \$150,000 and the Board’s Finance Committee to review contract statements of work of \$150,000 or more to ensure that the Board has oversight over large expenditures.

- **PURCHASES WITH FEDERAL FUNDS MUST BE ALLOWABLE, REASONABLE AND NECESSARY.** OMB’s *Circular A-122, Cost Principles for Non-Profit Organizations (Circular A-122)*, states that the costs charged to a federal award must be necessary and reasonable. *Circular A-122* defines a reasonable cost as one that, in its nature or amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs, and that the cost should be generally recognized as ordinary and necessary for the operation of the organization. *Circular A-122* further states that the reasonableness of specific costs must be scrutinized with particular care for organizations that receive most of

their funding from federal awards. In addition, purchases for meals are not allowable costs except for those related to travel and attendance at meetings or conferences.

- **CENTRALIZED PURCHASING CAN PROVIDE ORGANIZATIONAL AND COST EFFICIENCIES.** One procurement best practice among various types of organizations, including non-profits, for-profits, and government agencies, is requiring vendors to bill the organization directly rather than allowing employees to purchase goods and services for reimbursement. Requiring vendors to bill the organization for goods and services or requiring centralized purchasing, such as by an authorized staff using a business line of credit, generally provides greater financial controls over the organization's finances compared to allowing employees to purchase goods and reimbursing employees for their purchases. Centralization has the advantages of reducing duplication of effort, consolidating purchases to achieve lower costs, and enabling more control over inventory.

WHAT PROBLEMS DID THE AUDIT WORK IDENTIFY?

Throughout this audit, we identified problems in each area we reviewed related to Connect for Health's use and management of federal funds. Specifically, in Findings and Recommendations 1, 2, and 3, we identified audit exceptions in 35 out of the total 92 sampled vendor, contractor, and grantee payments and reimbursements (38 percent) and contracts. These problems totaled \$32,611,132, of which \$412,137 is questioned costs due to federal noncompliance. Overall, Connect for Health did not have sufficient processes and controls over expenditures to ensure federal funds were spent in compliance with regulations, or ensure funds were used prudently or efficiently. For example, as stated in the previous findings in this report, we found:

- Connect for Health made \$55,975 in payments to vendors and \$432,809 to grantees that were unallowable, unreasonable, or unnecessary according to federal regulations or contracts.

- Connect for Health paid some sampled vendors without fully executing contracts or out of compliance with their contracts, and made high-dollar payments to some vendors without Board approval. These problems resulted in \$170,296 in questioned costs.
- Connect for Health paid sampled vendors, contractors, and grantees \$185,866 without supporting documentation showing how the payment amounts were determined or the services provided.

In addition to the problems noted above, we identified other general problems with Connect for Health's accounting and use of federal funds that resulted in additional questioned costs totaling \$7,603. These problems included:

- **UNRECORDED OUT-OF-SEQUENCE CHECK NUMBERS.** Seventeen check numbers were not recorded in the general ledger during Fiscal Years 2013 and 2014. Connect for Health staff reported to us that 16 of these checks had been voided or not issued, and one \$116 check was misrecorded in the general ledger with the incorrect check number. Connect for Health did not have documentation explaining the reasons the checks were voided or not used. In addition, we reviewed Connect for Health's bank statements and identified one unrecorded check totaling \$850 that did clear the bank and, therefore, had not been voided. We were unable to determine if federal funds were used for this payment. This \$850 is questioned costs.
- **UNRECORDED OR MISRECORDED FUND SOURCES.** Connect for Health did not accurately record the source of funds, such as federal funds or private funds, used to pay for \$7,855 in catering services that it received in December 2013. Specifically, no source of funds was recorded in the general ledger for one \$2,170 catering payment in January 2014, and for another \$5,685 catering payment in January 2014, the general ledger stated that federal funds were used to pay the expense. However, Connect for Health staff reported to us that the general ledger was incorrect because insurance brokers for whom the catering had been purchased had reimbursed Connect for Health for

the catering expenses. At the time of our review in May 2014, the payments remained misrecorded in the general ledger.

- **CONNECT FOR HEALTH DID NOT TAKE SUFFICIENT STEPS TO CONTAIN PERSONNEL COSTS.** During Fiscal Years 2013 and 2014, Connect for Health hired a limited number of permanent staff but supplemented its operations with several high-paid contracted staff, which did not always appear to be a reasonable or prudent use of federal funds. For example, rather than hiring one staff member with contract negotiation and monitoring expertise, Connect for Health paid one contractor \$175 an hour and a total of \$1.69 million over 2 years to help negotiate and monitor information technology contracts; and paid another contractor \$180 an hour or \$537,000 total over 2 years to help negotiate contracts related to data warehousing and technical infrastructure.

Further, the general ledger showed that between September 2013 and February 2014, Connect for Health used federal funds to pay a total of \$6,753 for seven staff member's overtime meals, which did not appear to be ordinary and necessary for the operation of the organization or a reasonable use of federal funds. This \$6,753 is questioned costs.

- **MANAGEMENT AND STAFF PURCHASED THEIR OWN SUPPLIES, HARDWARE, AND SOFTWARE.** Connect for Health allowed 15 employees to purchase \$45,519 in office supplies, office equipment, computer hardware, and software during Fiscal Years 2013 and 2014, and Connect for Health reimbursed these individuals for their purchases with federal funds.
- **INSUFFICIENT CONTROLS OVER ACCOUNTING SYSTEM ACCESS.** Two staff and one contracted staff had administrator-level access to Connect for Health's accounting system, Intacct. Administrator access allows a person to perform all functions within the system, including adding and removing users and setting and changing functions that other users can perform in the system. Additionally, one contracted staff member had access and authority to approve, record, and issue

payments in the system. Further, based on the general ledger data and accounting documentation, we could not determine if Connect for Health had appropriate segregation of duties within its accounting functions. For example, it was unclear whether the same person had recorded and approved transactions and issued checks. Connect for Health management reported that it believed it had sufficient segregation of duties for its accounting functions.

- **OVER DRAFTED BANK ACCOUNT AND OVERDUE VENDOR PAYMENT.** During our review of sampled payments, we found that in September 2013, Connect for Health did not have sufficient funds in one of its bank accounts to cover a \$290 automatic bank fee and the fee caused the account to be overdrawn for the month. In addition, in another sampled payment we found that, in January 2014, Connect for Health was two months overdue in paying a vendor that was owed \$976. According to documentation, the bank and vendor did not charge Connect for Health overdraft or late payment fees, however, these problems demonstrate issues with the monitoring of Connect for Health's finances and outstanding debts.

WHY DID THE PROBLEMS OCCUR?

Overall, Connect for Health has not prioritized the development or implementation of adequate financial controls and accounting processes. The problems we identified occurred for the following reasons:

- **DEVELOPING THE HEALTH EXCHANGE QUICKLY WAS PRIORITIZED OVER FINANCIAL CONTROLS.** According to Connect for Health management and Board members, the organization has been focused on implementing the State's health insurance exchange and enrolling consumers in health plans, and the development of financial controls was a lesser priority. Management and some Board members reported that Connect for Health operated under tight federal deadlines to implement the exchange and believed they needed to spend funds quickly to ensure that the exchange was operational. Although the Board is ultimately responsible for overseeing the use of funds, it has

largely delegated oversight responsibilities to exchange management who had broad authority to conduct Connect for Health's affairs.

- **LACK OF SUFFICIENT POLICIES AND PROCEDURES TO ENSURE ACCURATE ACCOUNTING AND COMPLIANT FISCAL MANAGEMENT.** Connect for Health has not established basic financial policies and procedures to ensure: (1) transactions and checks are recorded accurately; (2) funds are sufficient to cover recurring fees; and (3) accounting staff functions are separate so that the same person cannot post, approve, and issue payments. According to Connect for Health's written Financial Procedures, the Controller makes bank deposits and records them in the accounting system, and the Controller or accountant reconciles the bank statements, accesses the accounting system to view the checks generated, and verifies deposits. In addition, the Controller and CFO have administrative rights to the accounting system and control check inventory, but management reported to us that these individuals do not have the authority to sign checks.

Connect for Health also has not established a policy related to staff reimbursements for supplies, equipment, and overtime meals, nor has the organization developed a process to centralize purchasing of office items, such as supplies and equipment.

- **LACK OF SUFFICIENT POLICIES AND PROCEDURES FOR IDENTIFYING AND ADDRESSING NONCOMPLIANT AND IMPRUDENT SPENDING.** Connect for Health has not implemented sufficient policies, procedures, or guidance requiring staff to identify, report, investigate, or correct transactions that appear noncompliant with federal regulations, state laws, and organizational requirements. In addition, the organization has not developed policies, procedures, or guidance requiring staff to report purchases or practices that appear inefficient or lead to waste or abuse of public funds. In May 2012, Connect for Health drafted a policy on fraud, waste, and abuse with a target approval date of June 2012, but the Board did not appear to approve or finalize this policy. In addition, Connect for Health accounting and grant-management staff we interviewed were not aware of any procedures or policies for

reporting suspected misuse of funds and other improper activities, including noncompliance with federal regulations.

- **LIMITED FINANCIAL STAFFING AND SUPERVISION.** Connect for Health management reported that it hired minimal staff to minimize the costs for personnel. However, management did not appear to have enough staff or financial supervisors to: ensure compliance with laws and policies; provide sufficient oversight of payments to vendors and grantees; ensure segregation of accounting duties so that the same person could not perform multiple conflicting accounting functions; prevent excessive payments to contract employees; or allow for consistent supervisory review and monitoring of accounting transactions. In addition, management and staff reported to us that Connect for Health had difficulties implementing the new Intacct accounting system during Fiscal Year 2014. Management told us that it had identified errors in the general ledger data, which prompted Connect for Health to hire an outside accounting firm to review the transactions in the general ledger to ensure they were recorded correctly before we began our audit testwork. Connect for Health did not have a standard internal process to review transactions recorded in the general ledger prior to hiring the accounting firm and delayed providing us the Fiscal Year 2014 general ledger data for approximately four months after we requested it.

- **RELIANCE ON FINANCIAL AUDITORS TO ENSURE FINANCIAL CONTROLS.** Connect for Health's draft policy on fraud, waste, and abuse, which is discussed above, states that internal financial procedures is one of the organization's five key risk areas and that the organization will rely on annual financial audits to ensure policies and procedures are properly followed. Connect for Health did not appear to recognize that it is management's, the Board's, and personnel's responsibility to ensure effective internal controls. For example, at the time of our audit, the organization had not established a sufficient internal mechanism to periodically review financial internal controls or check that staff followed federal requirements and organizational policies and procedures.

During the audit, Connect for Health management reported that it had undergone many audits and the organization had financial controls. To identify the problems that the prior audits had identified, in January 2014, we requested copies of all internal and external audits, reviews, and studies that had been conducted of the organization, including financial, performance, and information technology audits.

In response to our request, management reported that Connect for Health had undergone two financial and single audits of federal funds, one in 2012 and one in 2013. Connect for Health had also undergone five information technology independent verification and validation (IV&V) reviews. Connect for Health hired independent firms to conduct the two financial audits and IV&V reviews. Connect for Health also self-reported various information to CMS, such as its progress with website development and quarterly federal grant expenditures so that CMS could monitor the organization's progress in implementing the exchange; and management reported that CMS made site visits to the organization. However, this self-reporting and the site visits did not constitute actual audits. Connect for Health did not provide the audit team any other audits, studies, or reviews conducted of the organization and, based on our review, the organization had not undergone any other audits, besides the two financial audits, prior to the start of our audit in January 2014. In the summer of 2014, the Office of Inspector General for the federal Department of Health and Human Services began audits of Connect for Health. The findings of these federal audits have not been reported.

We reviewed the results of Connect for Health's two financial audits to identify whether the auditors had identified problems related to financial administration and accounting. In 2012, the financial auditors reported that they did not identify problems with Connect for Health's financial internal controls that were material weaknesses and did not report problems with federal compliance. In 2013, Connect for Health's financial auditors identified a material weakness in the financial statements including recording errors totaling \$1.8 million.

The auditors recommended delaying the beginning of the Fiscal Year 2014 financial audit to allow Connect for Health staff more time to review whether the general ledger entries are correct. Connect for Health did not appear to implement a corrective action plan, policies, or procedures, or take other actions to address the financial control problems that led to the material weakness.

WHY DO THESE PROBLEMS MATTER?

Comprehensive steps to improve financial internal controls are needed to ensure accountability to taxpayers for the effective use of the approximately \$41.2 million remaining that Connect for Health is expected to receive in federal funds. By not having strong controls over payments, procurement, and accounting, Connect for Health cannot ensure that federal funds are being spent appropriately and for services needed to implement and operate the health exchange. When Connect for Health does not accurately record checks and whether federal funds were used as the source of payment, it cannot accurately track federal spending and risks making inaccurate reimbursement requests to CMS. Further, when Connect for Health does not properly segregate the duties of accounting staff and appropriately limit access to the accounting system, it cannot ensure that its spending of federal funds complies with federal regulations, or sufficiently protect against fraud, abuse, and inefficient use of the organization's resources.

In addition, Connect for Health's future revenue growth may be limited because it is required to be self-sustaining beginning in 2015, meaning that it cannot receive federal grant funds for operations after that date, and state statute [Section 10-22-108, C.R.S.] prohibits Connect for Health from receiving state general funds. Without strong controls in place to monitor spending and ensure expenses are prudent, problems with the organization's use of public funds and financial management could continue or cause difficulty in achieving and maintaining sustainability.

CLASSIFICATION OF FINDING: SIGNIFICANT DEFICIENCY

RECOMMENDATION 4

Connect for Health Colorado and the Board of Directors (Board) should improve fiscal management by:

- A Establishing and implementing appropriate written financial policies, procedures, and internal controls that ensure proper accounting, recording of all financial transactions and checks, and compliance with applicable laws, regulations, and internal requirements. This should include developing procedures for identifying, reporting, investigating, and correcting transactions that appear noncompliant with laws, regulations, and requirements; developing policies and procedures over reimbursing staff for purchases, such as supplies, equipment and overtime meals; and considering centralizing procurement for office items such as supplies and equipment.
- B Ensuring that an appropriate number of staff and supervisors are assigned to accounting functions, with the appropriate levels of system access and segregation of duties controls in place.
- C Establishing and implementing periodic risk-based quality control reviews to ensure organizational compliance with laws, regulations, and internal policies and procedures. This should include reporting the results of the reviews to the Board, and revising policies and procedures, as appropriate, based on the results of the reviews.
- D Training Board members, management, and appropriate staff on the policies and procedures established in recommendation PARTS A, B, and C above.

RESPONSE

CONNECT FOR HEALTH COLORADO

- A AGREE. IMPLEMENTATION DATE: MARCH 2015.

Please see responses in Recommendations 1 through 3. Connect for Health Colorado will establish and implement additional appropriate written financial policies, procedures, and internal controls that ensure proper accounting, recording of all checks and financial transactions, and compliance with applicable laws, regulations, and internal requirements. This will include developing more robust procedures for identifying, reporting, investigating, and correcting transactions that appear noncompliant with laws, regulations, and requirements; developing policies and procedures over reimbursing staff for purchases, such as supplies, equipment and overtime meals; and considering centralizing procurement for office items such as supplies and equipment. Additional improvements will include financial policies, procedures, and internal controls regarding all revenue transactions. Employee reimbursement requests are now formalized in an on-line accounting process requiring documentation and approval.

With the continuing maturation of Connect for Health from its initial start-up as a new state-based marketplace, accounting and oversight processes for low-dollar recurring expenses will be established through appropriate accounting protocols. Connect for Health will use a corporate credit card to expedite and control the recurring low-dollar administrative costs with appropriate use restrictions and oversight.

B AGREE. IMPLEMENTATION DATE: JUNE 2015.

Connect for Health Colorado agrees with the state audit findings and will review current staffing and make changes as needed to ensure that an appropriate number of staff and supervisors are assigned to accounting functions, with appropriate levels of system access and segregation of duty controls. From the first full operations as a new non-profit in 2012, Connect for Health has focused on identifying staffing needs and stabilization within all functional areas of operation. Vendor billing and payment processes continue to evolve to meet identified needs as Connect for Health continues to establish itself as a sustainable organization.

Connect for Health Colorado is currently searching for a new CFO with the assistance of a professional search firm and the first priority is hiring a new CEO/Executive Director. An internal audit position is under consideration given the volume and burden associated with numerous audits, reviews, and material inquiries received by Connect for Health since its inception. Connect for Health retained general

counsel with over 25 years of experience in September 2014 to assist with implementing an organization-wide governance and compliance program addressing the breadth and scope of the each recommendation provided by the Office of the State Auditor.

C AGREE. IMPLEMENTATION DATE: APRIL 2015.

Connect for Health Colorado submitted an Oversight and Monitoring Program description to the Centers for Medicare and Medicaid as part of a comprehensive process to implement an overarching and holistic monitoring, compliance, and quality control program for the functional and operational components of a state-based marketplace. The comprehensive program description was submitted for review and feedback on October 17, 2014. Connect for Health Colorado will establish and implement periodic risk-based quality control reviews to ensure organizational compliance with laws, regulations, and internal policies and procedures; report the results of the reviews to the Board; and revise policies and procedures, as appropriate, based on the results of the reviews.

As Connect for Health Colorado moves from a start-up organization in the implementation phase to sustainability and operation as a more mature entity, oversight, monitoring, compliance and quality control processes will be continually reviewed and amended as the regulatory environment evolves at both a state and a federal level. Connect for Health recognizes its obligation to ensure ongoing compliance and appropriate market conduct in keeping with its statutory mission.

D AGREE. IMPLEMENTATION DATE: JUNE 2015.

Connect for Health Colorado will train Board members, management, and appropriate staff on the policies and procedures established in Recommendation 4, Parts A, B, and C above, as detailed throughout the various responses contained herein. Connect for Health will work with Board members, management, and staff to determine the most effective way of conducting this training including staff meetings, on-line training, new staff training, and any other methods identified.

