DEPARTMENT OF TECHNOLOGY SERVICES

Single Audit Management Letter
For the Year Ended June 30, 2019

Report No. 19-23

OFFICE OF THE
STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Gregg Hastings, CPA, Audit Manager
Andrew Driggs, Audit Senior

DEPARTMENT OF TECHNOLOGY SERVICES

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FOR THE YEAR ENDED JUNE 30, 2019

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SINGLE AUDIT MANAGEMENT LETTER NO. 19-23

December 12, 2019

Mr. Mike Hussey, CIO/Executive Director
Department of Technology Services
1 State Office Building, Floor 6
SLC, Utah 84114

Dear Mr. Hussey:

This management letter is issued as a result of the Department of Technology Services' (Department's) portion of the statewide single audit for the year ended June 30, 2019, for which we tested the Department's working capital reserves. Our final report on compliance and internal control over compliance issued to meet the reporting requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) is issued under separate cover.

In planning and performing our audit of working capital reserves, we considered the Department's compliance with the types of compliance requirements subject to audit as described in the *OMB Compliance Supplement* for the year ended June 30, 2019. We also considered the Department's internal control over compliance with the types of requirements described above that could have a direct and material effect on working capital reserves in order to determine the auditing procedures that were appropriate in the circumstances for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or to detect and correct on a timely basis noncompliance with a type of compliance requirement of a federal program. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness, yet important enough to be reported under Uniform Guidance.

Our consideration of internal control over compliance was for the limited purposes described in the second paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Department's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that were not identified.

We identified an instance of noncompliance which we are required to report under Uniform Guidance. This matter is described in the accompanying finding and recommendation.

The Department's written response to and Corrective Action Plan for the finding identified in our audit were not subjected to the audit procedures applied in our audit and, accordingly, we express no opinion on them.

The purpose of this communication is solely to describe the scope of our testing of internal control over compliance and the results of that testing. Accordingly, this communication is not suitable for any other purpose. However, pursuant to *Utah Code* Title 63G Chapter 2, this report is a matter of public record, and as such, its distribution is not limited.

We appreciate the courtesy and assistance extended to us by the personnel of the Department during the course of our audit, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

Gregg Hastings

Gregg Hastings, CPA
Audit Manager
801-808-0293
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cc: Daniel S. Frei, Finance Director
John Reidhead, Chief Financial Officer, State Division of Finance

WORKING CAPITAL RESERVES IN EXCESS OF FEDERAL GUIDELINES

Federal Agencies: **Various**
CFDA Numbers and Titles: **Various**
Federal Award Numbers: **Various**
Questioned Costs: **Undeterminable**
Pass-through Entity: N/A
Prior Year Single Audit Report Finding Number: **2018-035**

As of June 30, 2019, the Department of Technology Services held working capital reserves in excess of federal guidelines as follows:

> **Service Area Level –** Hosting Services
> **Excess # of Days in Reserve** – 59
> **Excess Amount in Reserve** – $2,581,609

2 CFR part 200, Appendix V, paragraph G.2, generally allows a working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes in each internal service fund. However, based on federal cost negotiator guidelines, the Department's reserves are currently calculated at the service area level with a maximum allowed 45 days of reserves. It is inherently difficult to accurately estimate expenses and their effect on working capital reserves when setting rates. Excess reserves could result in a federal liability since federal programs share an interest in the reserves.

Recommendation:

Depending on the business requirements, we recommend the Department of Technology Services reduce excess working capital reserves for its Hosting Services service area level or obtain a waiver from the federal cost negotiator allowing for an increase in the number of days of working capital allowed to comply with federal guidelines.

Department's Response:

We agree with the findings from the State Auditor's Office.

Corrective Action Plan:

Partial Corrective Action Achieved
DTS gave significant mid-year rate reductions and rebates in both FY 2018 and FY 2019 to Hosting Services customers of about $1.3 million and $900 thousand respectively. In addition, DTS has proposed rates for FY 2020 and FY 2021, which are lower than the projected actual costs to provide this service. This was done in order to further draw down Hosting Services retained earnings by about $1.7 million in FY 2020 and $900 thousand in FY 2021.

Further Corrective Action Plan
The advent and adoption of cloud based hosting technology will continue to change DTS operations and demand for DTS Hosting Services. As part of the DTS strategic plan, DTS will

take advantage of cloud based hosting to provide even more efficient services. DTS is positioned to assist customers with a switch from hosting with DTS in the State Data Center to hosting with another provider. This switch will impact revenue; funds that would have been paid to DTS will now be paid to an outside vendor. Finally, many agencies are taking advantage of software as a service which, in some instances, moves the hosting services away from DTS to a vendor used by the software company. DTS currently estimates it will lose at least $1.1 million to cloud based hosting services alone in FY 2020 and another $1 million in FY 2021. These amounts are conservative estimates and if cloud based hosting services adoption continues to rise, DTS will likely see additional revenue shortfalls.

As customers continue to transition from DTS Hosting services to cloud based hosting services, DTS will closely track the impact to Hosting Services revenues and expenses. DTS will annually review and adjust rates and will issue mid-year rebates if necessary to bring DTS Hosting Services into compliance with Federal excess reserve guidelines by the end of FY 2022.

Contact Person: Daniel Frei, Finance Director, 801-538-3459
Anticipated Correction Date: FY2022 anticipated completion date