DEPARTMENT OF ADMINISTRATIVE SERVICES

Management Letter
For the Year Ended June 30, 2018

Report No. 18-18

OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Jon Johnson, CPA, Deputy State Auditor
Jason Allen, CPA, Senior Audit Manager
Gregg Hastings, CPA, Audit Manager
Andrew Driggs, Audit Senior

DEPARTMENT OF ADMINISTRATIVE SERVICES

FOR THE YEAR ENDED JUNE 30, 2018

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OFFICE OF THE
STATE AUDITOR

MANAGEMENT LETTER NO. 18-18

December 11, 2018

Tani Downing, Executive Director
Department of Administrative Services
3120 State Office Building
Salt Lake City, Utah 84114

Dear Ms. Downing:

This management letter is issued as a result of our audit of the basic financial statements of the State of Utah as of and for the year ended June 30, 2018 in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Our report thereon, dated December 4, 2018, is issued under separate cover. This management letter is also issued as a result of the Department of Administrative Services' (Department's) portion of the statewide single audit for the year ended June 30, 2018. 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 also issued under separate cover.

In planning and performing our audit of the financial statements of the State of Utah, we considered the Department's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Additionally, in planning and performing our statewide single audit procedures, we considered the Department's compliance with the relevant compliance requirements as described in the *OMB Compliance Supplement* for the year ended June 30, 2018. We also considered the Department's internal control over compliance with those requirements in order to determine the auditing procedures that were appropriate in the circumstances for the purpose of expressing opinions on major federal program 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.

A *deficiency in internal control over financial reporting* or *compliance* exists when the design or operation of an internal control 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 financial statement misstatements or noncompliance with a type of compliance requirement of a federal program. A *material weakness in internal control over financial reporting* or *compliance* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that material financial statement misstatements or 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 financial reporting* or *compliance* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purposes described in the second paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

We did not identify any deficiencies in the Department's internal control that we consider to be material weaknesses.

We identified an instance of noncompliance which we are required to report under Uniform Guidance. This matter is described in the accompanying schedule of findings and recommendations as Finding Number 1.

During our audit, we also became aware of a deficiency in internal control that is reported as an opportunity for strengthening internal controls and operating efficiencies. This other finding is also included in the accompanying schedule of findings and recommendations as Finding Number 2.

The Department's written responses to and Corrective Action Plan for the findings 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.

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,

Jon T Johnson

Jon Johnson, CPA
Deputy State Auditor
801-538-1359
jonjohnson@utah.gov

cc: John Reidhead, Chief Financial Officer, State Division of Finance
Ken Hansen, Deputy Director, State Division of Finance
Janica Gines, Assistant State Comptroller, State Division of Finance
Cory Weeks, Accounting Operations Manager, State Division of Finance
Christopher Hughes, Director, Division of Purchasing and General Services
Brian Nelson, Director, Risk Management
Jeff Mottishaw, Director, Division of Fleet Operations

1. 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 Numbers: **2017-021, 2016-037; 2015-048; 2014-040; 2013-049; 12-51; 11-56**

As of June 30, 2018, four funds within the Department of Administrative Services held working capital reserves in excess of federal guidelines as follows:

Fund Description	Excess # of Days in Reserve	Excess Amount in Reserve
Division of Purchasing and General Services:		
Cooperative Contract Management	66	$ 562,287
Print Services	98	$ 414,770
State Surplus Property	64	$ 112,079
Division of Finance:		
Purchase Card Services	901	$ 452,092
Division of Risk Management:		
Workers Compensation Fund	146	$ 2,804,076
Property Liability Self-Insurance Fund	92	$ 3,411,257
Division of Fleet Operations:		
Motor Pool	131	$ 6,390,348
Travel Office	25	$ 36,380

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. 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 that the Department of Administrative Services reduce excess working capital reserves within each of the respective funds 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 of Administrative Services' Response:

We concur. We have developed corrective action plans and are working with the U.S. Department of Health and Human Services, Program Support Center, Cost Allocation Services in resolving these excess reserves.

Corrective Action Plans:

Division of Purchasing and General Services

Cooperative Contract Management—The Division of Purchasing and General Services (Division) is allowed under law to collect up to a 1.0% administrative fee on each cooperative contract. The Division of Purchasing has been decreasing its administrative fees each time a contract expires and is rebid. Currently, the average administrative fee is 0.38%. This, however, is a slow process since contracts only expire and are rebid every five years and the Division has nearly 1,000 state cooperative contracts. The Division has also experienced an increase in the usage of its state cooperative contracts by public entities each year over the past seven years. With this increase in the usage of state cooperative contracts has come a corresponding increase in the collection of administrative fees. If the adjustment of fees had simply involved decreasing the fees on a fixed usage of the contracts, the Division would have been able to reduce their retained earnings much sooner. The Division will continue to review and decrease the administrative fees on each of its state cooperative contracts as each contract expires and is rebid. In addition, the Division has also invested in a new contract usage system and analytics tool. This new system will help improve the management of its cooperative contracts and will assist the Division in anticipating usage and decreasing the administrative fee of appropriate contracts.

Print Services—State Print Services charges an administrative rate for each impression on its leased copiers. Over the past several years, more agencies have started to use the services provided by Print Services and the administrative rate from Print Services has exceeded the annual expenses. Print Services is currently reviewing the administrative fees associated with its program to determine if they can be lowered.

State Surplus Property—State Surplus Property will be relocating in 2021 when the Utah State Prison is relocated. As part of this relocation, State Surplus Property will need to invest in a new building. State Surplus Property will use the excess funds to invest in a new building.

Contact Person: Christopher Hughes
Anticipated Correction Dates: Cooperative Contract Management, June 30, 2020;
Print Services, June 30, 2020; and
State Surplus Property, June 30, 2021.

Division of Finance

Excess Purchasing Card Services working capital reserves were rebated to participating state agencies and other governmental customers in August 2018. The federal portion of the rebates was remitted to the Federal Cost Allocation Services in October 2018. The disbursements from the rebates and federal portion combined totaled $456,086, which lowered the working capital reserves for Purchasing Card Services below the 60-day federal limit.

Contact Person: Cory Weeks, Accounting Operations Manager, 801-538-3100
Anticipated Correction Date: October 15, 2018

Division of Risk Management

Workers Compensation Fund—The Division of Risk Management (Division) submitted to Cost Allocation Services (CAS) in July 2018 a calculation of the federal portion to refund for the $2.5 million appropriation transferred out of this fund in fiscal year 2018. CAS is still in the process of reviewing this proposed federal refund. The Division has asked for legislative approval for another $3 million appropriation transfer out of this fund for fiscal year 2019. The calculation of the federal refund amount for this additional transfer out will be submitted to CAS when this transfer is completed. The Division has also requested a rate decrease beginning in fiscal year 2020.

Property Liability Self Insurance Fund—The Division has used a lower property rate than the actuary recommended for Fiscal years 2019 and 2020 to reduce retained earnings. The Division will watch results and request rates for fiscal year 2021 appropriate to keep retained earnings within (the 60-day) Federal Guidelines.

The Division plans on requesting legislative approval for a $3.0 million appropriation transfer out of this fund for fiscal year 2020. The calculation of the federal refund amount for this transfer out will be submitted to CAS when this transfer is completed.

Contact Person: Brian Nelson, Director, 801-538-9576
Anticipated Correction Date: June 30, 2020

Division of Fleet Operations

Motor Pool—The excess of Retained Earnings is a direct result of our efforts to pay down the Debt to the General Fund, which was a directive from our Department and Legislative Subcommittee. The debt reduced from $41.6 million in 2014 to $21.6 million in 2018, while simultaneously reducing our rates to our customers. As previously agreed with Cost Allocation Services (CAS), the Division of Fleet Operations (Division) plans on refunding during fiscal year 2019 the federal portion of the Motor Pool ISF excess reserve balance as of June 30, 2018. The Division has also decreased the Motor Pool ISF rates for fiscal year 2019 and has proposed for legislative approval another decrease for fiscal year 2020. It is *also continuing work on the fleet management software and reporting platform upgrades, and the installation of several thousand vehicle telematics units. All of these purchases will increase the Motor Pool ISF's data processing, current, and depreciation expenses, and will help to reduce the fund's future net income, and retained earnings.*

Travel Office—The small excess working capital balance in the Travel Office ISF was caused by a one-time six-month overlap in program rebate processes. The Division expects this excess balance to be eliminated by June 30, 2020. If any remaining excess reserve balance remains at that time, the Division plans on refunding the federal portion of any remaining excess balance during fiscal year 2021.

Contact Person: Jeff Mottishaw, Director, 801-538-3601
Anticipated Correction Date: Motor Pool, June 30, 2019; Travel Office, June 30, 2020

2. INADEQUATE CONTROLS OVER LEAVE ALLOCATIONS

During the past five years, the Office of the State Auditor has issued five findings to four different State departments/agencies related to inequitable or erroneous leave allocations. The 2015 audit also included leave allocation issues as a significant deficiency in the statewide *Government Auditing Standards* report on internal control over financial reporting. During the 2018 audit, we have issued three new findings to three new departments/agencies (Departments of Natural Resources, Department of Agriculture and Food, and the Commission on Criminal and Juvenile Justice) related to inappropriate leave allocations. Based on past experience, we believe this issue likely exists at other agencies or offices throughout the state. We are also concerned with the lack of a coordinated effort to resolve this ongoing concern.

These errors are typically related to situations where employees worked on multiple federal- or state-funded activities and the hours charged for leave taken (e.g. annual leave, sick leave, holidays, etc.) were not equitably or accurately allocated between the activities.

The lack of appropriate leave allocations has occurred for various reasons, including:

- The State payroll system, managed by the Department of Administrative Services' Division of Finance (Division of Finance), charges leave taken to predetermined account coding;
- Some departments were not aware that leave charges to predetermined account coding may require subsequent reviews and allocations;
- Some departments may have been aware of the need for these allocations but have chosen to charge the leave solely to State funding sources; and
- Other departments were aware of the potential need for these allocations but incorrectly calculated the allocations.

Even though most departments have become aware of these issues and have developed methods to review and allocate the leave charges when necessary, we believe that some of these methods may be cumbersome and overly time consuming. We feel that the State has not provided sufficient systems, methods, or guidance to adequately and efficiently address the leave allocation issues for all State agencies. The failure to appropriately address leave allocation issues for all state agencies is resulting in inefficient manual allocations, lost federal revenues and may result in inequitable charges to applicable funding sources.

Recommendation:

We recommend the Division of Finance improve systems or methods to more efficiently and accurately resolve leave allocation issues. We also recommend the Division of Finance improve its monitoring efforts and internal controls over the leave allocation processes to ensure resolution of this issue for all state agencies and offices.

Department of Administrative Services' Response:

We concur.

Corrective Action Plan:

The Division of Finance (Division) has worked to improve agencies' understanding of the requirement to allocate leave equitably to state and federal programs by providing training and by working with agencies to help isolate leave in the accounting system to aid them with their allocation methodologies. We have seen improvement in the agencies with major federal programs; however, we do recognize that there continues to be a risk of noncompliance with smaller agencies or those with few federal programs.

To address this risk and to continue to ensure all agencies are aware of the requirement, the Division will ensure that clear guidance is provided to agencies in the payroll section of the Division's accounting policies. The Division will also ensure that this requirement is discussed annually in the Budget and Accounting Officers Meeting related to close-out because proper allocation is integral to proper close-out. In addition, the Division will include the requirement in the Payroll Internal Control Questionnaire provided to agencies on a rotating basis. The Division will also continue to work with agencies to develop and improve methods for allocating leave. Finally, the Division will reach out to other states to determine if there are best practices for these allocations, including methods being used to automate the process that would be feasible to implement.

Contact Person: Janica Gines, Assistant Comptroller, 801-538-1678
Anticipated Correction Date: June 30, 2019