DEPARTMENT OF TECHNOLOGY SERVICES

Single Audit Management Letter
For the Year Ended June 30, 2018

Report No. 18-17

OFFICE OF THE
STATE AUDITOR

AUDIT LEADERSHIP:
John Dougall, State Auditor
Gregg Hastings, CPA, Audit Manager
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DEPARTMENT OF TECHNOLOGY SERVICES

Single Audit Management Letter

FOR THE YEAR ENDED JUNE 30, 2018

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SINGLE AUDIT MANAGEMENT LETTER NO. 18-17

December 11, 2018

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, 2018, 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 applicable types of 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 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 merit attention by those charged with governance. We did not identify any deficiencies in the Department's internal control that we consider to be material weaknesses.

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 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 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.

We appreciate the courtesy and assistance extended to us by Department personnel 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: N/A

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

Fund Description	Excess # of Days in Reserve	Excess Amount in Reserve
Service Area Level		
Hosting Services	35	$ 1,481,770
Network Services	8	$ 432,053

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 that the Department of Technology 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 Technology Services' Response:

The Department of Technology Services (DTS) agrees with the Auditor's recommendation and will eliminate the Federal excess reserves in Hosting and Network services by the end of FY2020. DTS continues to look for ways to provide more efficient technology solutions to executive branch agencies. Because of these efficiencies, DTS was able to provide Hosting and Network services for less than the rate approved by the Legislature. DTS has already taken steps to correct both of these excess reserve balances.

Corrective Action Plan:

Hosting – FY2018, DTS gave a significant mid-year rate reduction and rebate to customers for hosting services. In addition, DTS has already proposed a rate for FY2020, which is lower than *the actual costs to provide the service in order to further draw down on retained earnings. These two steps will mostly eliminate the excess reserve noted in the audit.*

Furthermore, DTS is currently experiencing many changes around the way hosting services are provided due to the advent of cloud hosting. As part of the DTS strategic plan, DTS would like to take advantage of cloud 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.

It is difficult to project the impact on retained earnings that will result from changes in the hosting environment and it will probably take a couple of years to materialize. DTS will closely track the impact to Hosting revenues and expenses as a result of these changes. DTS may also implement a rebate to agencies, if necessary, in order to be in compliance with Federal excess reserve guidelines by the end of FY2020.

Network – DTS has set budgets in FY2019 that will draw down these excess reserves. DTS will monitor revenues and expenses and implement a rebate if the excess reserve will not be eliminated by the end of FY2019.

Contact Person: Dan Frei, Finance Director, 801-538-3459
Anticipated Correction Date: June 30, 2020