DEPARTMENT OF TECHNOLOGY SERVICES

Single Audit Management Letter
For the Year Ended June 30, 2020

Report No. 20-22

OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Doug Seager, CPA, Audit Director
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DEPARTMENT OF TECHNOLOGY SERVICES

Single Audit Management Letter

FOR THE YEAR ENDED JUNE 30, 2020

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FINDINGS AND RECOMMENDATIONS:	Federal Program	Applicability	
Working Capital Reserves in Excess of Federal Guidelines	Various	RN-f	3

Finding Type:		Applicable To:	
SD	Significant Deficiency of Internal Control	s	State Financial Statements
RN	Reportable Noncompliance or Illegal Acts	f	Federal Program

SINGLE AUDIT MANAGEMENT LETTER NO. 20-22

January 26, 2021

Mr. John Angus, Acting CIO
Department of Technology Services
1 State Office Building, Floor 6
SLC, Utah 84114

Dear Mr. Angus:

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, 2020, 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, 2020. 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,

Doug Seager, CPA
Audit Director
801-808-0507
dseager@utah.gov

cc: Daniel S. Frei, Finance Director
Patricia Nelson, Assistant State Comptroller, 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: **2019-025; 2018-035**

As of June 30, 2020, 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	40	$1,802,636
Network Services	18	$1,033,957

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. The excess reserves were due to the inherent difficulty of accurately estimating expenses 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's Response:

***View of Responsible Officials**: We agree with the finding*

***Finding:** Working Capital Reserves in Excess of Federal Guidelines (Utah Department of Technology Services)*
***Status:** Partially corrected. (Hosting Services)*
***Reasons for Recurrence:** The adoption of cloud based hosting technologies has been slower than anticipated due to an effort by the Department of Technology Services (DTS) to implement strong governance and best practices in this area. DTS has also taken a conservative approach regarding spending by only investing in the infrastructure needed in the near term with the expectation that they will need to increase investment as cloud based hosting usage increases.*

Partial Corrective Action Taken: *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.*

Corrective Action Planned: *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 is currently projecting to be a mere 650k above allowed retained earnings by the end of FY2021; however, staffing changes and large cloud related purchases coupled with reductions in our Storage and Backup services revenue may put us in line with the 45 day allowed amount by the end of FY21 and certainly by the goal date at the end of FY22. 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.

Corrective Action Plan:

The Network Services product saw a number of significant unanticipated reimbursements in FY20 and FY21 which contributed to the majority of this overage in retained earnings. The product also had unanticipated unfilled FTEs in FY21, which will result in a projected savings. In addition, DTS anticipates significant expenses to this product in FY2021 and FY2022 as DTS upgrades the aging network infrastructure and as the demand for network services is ever increasing (e.g. Agencies are asking for increased bandwidth). DTS anticipates that the retained earnings balance will be in compliance by the end of FY2022.

Contact Person: Dan Frei, Finance Director
Anticipated Correction Date: June 30, 2022