

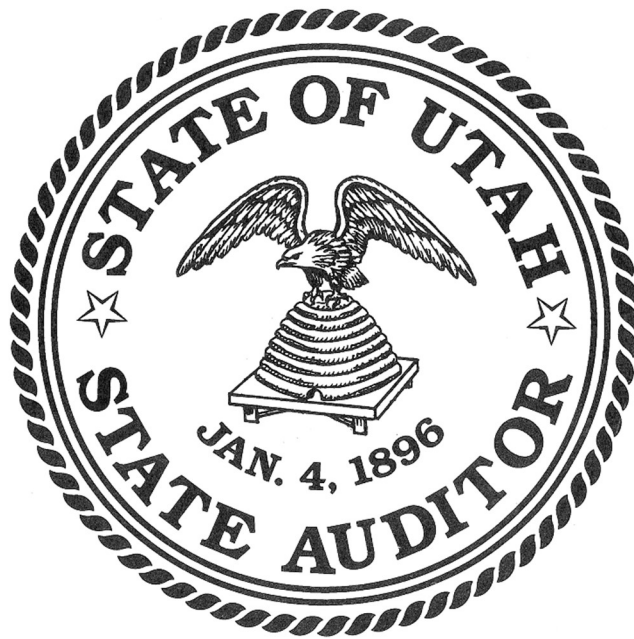
# Department of Government Operations

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Management Letter  
*For the Year Ended June 30, 2021*

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Report No. 21-16



Office of the  
**State Auditor**

AUDIT LEADERSHIP:

John Dougall, State Auditor  
Hollie Andrus, CPA, Deputy State Auditor  
Andrew Driggs, CPA, Audit Supervisor

# Department of Government Operations

For the Year Ended June 30, 2021

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## Department's Response

### Finding Type:

MW Material Internal Control Weakness  
SD Significant Deficiency of Internal Control  
MN Material Noncompliance  
RN Reportable Noncompliance or Illegal Acts

### Applicable To:

s State Financial Statements  
f Federal Program



Office of the  
**State Auditor**

## Management Letter No. 21-16

April 27, 2022

Ms. Jenney Rees, Executive Director  
Department of Government Operations  
4315 South 2700 West, 3<sup>rd</sup> Floor  
Taylorsville, UT 84129-2128

Dear Ms. Rees:

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, 2021. It is also issued as a result of the Department of Government Operations' (DGO's) portion of the statewide federal compliance audit (Single Audit) for the year ended June 30, 2021. Our audit was conducted 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 final reports on internal controls and on compliance required under *Government Auditing Standards* and federal *Uniform Guidance* will be issued under separate cover. These reports will provide further detail as to considerations made during the course of the audit regarding internal controls and compliance, both at the financial statement and at the federal program level, and the limited purposes of those considerations. The purpose of this letter is to communicate with DGO management concerns identified during the course of our audit.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees to prevent or to detect and correct on a timely basis misstatements, errors, or instances of noncompliance. A material weakness in internal control is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that material misstatements, errors, or noncompliance are not prevented or are not detected and corrected on a timely basis.

We identified deficiencies in internal control which, while not considered material, we consider to be significant enough to merit the further attention of management and those charged with governance (Findings 1 and 2). We also identified Finding 3 as an instance of noncompliance which we are required to report under *Uniform Guidance*.

DGO's written response to and Corrective Action Plan for these findings will be included in the final reports identified in the second paragraph above.

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 and not to provide an opinion on the effectiveness of the DGO's internal control over compliance. 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 DGO personnel extended to us during the course of our audit, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Hollie Andrus".

Hollie Andrus, CPA  
Deputy State Auditor  
801-808-0467  
handrus@utah.gov

cc: Marilee Richins, Deputy Director, Department of Administrative Services  
Janica Gines, CPA, Director, Division of Finance  
Patricia Nelson, CPA, Assistant State Comptroller  
Christopher Hughes, Director, Division of Purchasing and General Services  
Jim Russell, Director, Division of Facilities Construction & Management  
David Williams, Finance Director, Division of Facilities Construction & Management  
Brian Nelson, Director, Division of Risk Management  
Alan Fuller, Chief Information Officer, Division of Technology Services  
Daniel Frei, Finance Director, Division of Technology Services

## Findings and Recommendations

### Finding 1. Errors in Preparation Process in Financial Reporting

The Division of Finance (Finance) within the Department of Government Operations does not have adequate internal controls to ensure it prepares the State's Annual Comprehensive Financial Report (ACFR) in accordance with generally accepted accounting principles. Auditors detected errors in both information provided to Finance and information prepared by Finance during the ACFR preparation process. As a result, multiple adjustments were needed in order to fairly present the State's financial activity.

#### **Finance Relied on Inaccurate Information Provided by Other Agencies**

Finance frequently relies on information provided by other agencies when recording financial activity for the ACFR. While it detected inaccurate agency-prepared financial information, Finance personnel failed to perform sufficient reviews to detect *and correct* these errors, resulting in a \$44.8 million reduction of Income Tax revenues and the correction of \$52.8 million of capital asset transfers to agencies and discrete component units.

#### **Finance Prepared & Recorded Inaccurate Financial Activity**

Auditors detected a number of errors that occurred during Finance's closeout and compilation of the ACFR. These errors resulted in adjustments ranging from \$33.1 million to \$275 million to properly reflect and classify June 30 receivables balances, June 30 claims liability balances, and capital project activity. Finance failed to perform and document sufficient reviews to detect and correct these errors.

To ensure the ACFR materially reflects the State's financial position and results of operations, Finance should perform and document sufficient reviews of information prepared by state agencies and Finance personnel. Inadequate controls over the preparation process may result in material undetected errors.

#### **Recommendation:**

**We recommend Finance establish, perform, and document internal controls sufficient to ensure information prepared by State agencies or by Finance materially reflects the State's financial position and results of operations.**

#### *DGO's Response:*

*We agree with the findings and recommendations outlined in your Management Letter.*

# Department of Government Operations

Management Letter  
For the Year Ended June 30, 2021

## *Corrective Action Plan:*

*The individual income taxes revenue estimate is prepared by economists at the Utah State Tax Commission. The Division of Finance (State Finance) relies on the professional expertise and system of internal controls of the Tax Commission in preparing and reviewing the estimate. Additionally, State Finance performs analytical reviews to determine the reasonableness of the estimate based on 3 and 4-year historical forecasts and actual revenue collection averages. We also compare the current forecast amount to other economic indicators for Utah and the United States as provided by the Governor's Office of Planning and Budget to determine its reasonableness. The \$44.8 million error in the current year estimate was a result of the Tax Commission economists failing to utilize the proper assumptions for the estimate. In the future, State Finance will obtain a listing of current year assumptions applied by the Tax Commission economists in their preparation of the sales tax revenue estimate and review them for reasonableness and consistency.*

*The Division of Facilities and Construction Management (DFCM) prepares the State's schedule of construction in progress which contained an error of \$52.8 million. See management's response for finding No. 2.*

*The \$275 million correction of an error was a result of a review of State Finance's policy on accounting for specific transactions between the DFCM and discrete components. While State Finance properly applied the policy, the auditors determined and State Finance agreed that the policy developed and utilized since 2002 was not consistent with GAAP. State Finance will review our current policies and procedures to ensure they are consistent with GAAP.*

*State Finance is continually re-evaluating and attempting to improve internal controls over financial reporting by identifying potential internal control weaknesses and inefficiencies with the Annual Report process. The majority of the other types of reclassification errors noted by the auditor were related to the implementation of a new and complex governmental accounting standard combined with turnover in key Financial Reporting Section (Section) personnel. State Finance will continue to update written procedures and cross train employees to ensure continuity of job responsibilities. State Finance will also provide training to Section staff and supervisors on State procedures, systems of internal control, and governmental accounting. Additional monitoring will be added to the Annual Report process where needed to address the inexperience of the Section staff. State Finance is also committed to attracting, hiring and retaining the most qualified financial accounting personnel through re-envisioning recruiting techniques and evaluation of position ranges and classifications.*

*Contact Person: Patricia Nelson, Assistant State Comptroller, State Division of Finance  
patriciarnelson@utah.gov*

*Anticipated Correction Date: June 30, 2022*

## Finding 2. Improper Capitalization and Transfer of Assets

During the preparation of the fiscal year 2021 ACFR, the Division of Facilities Construction and Management (DFCM) and the Division of Finance (Finance) did not consistently and appropriately apply capitalization policies for the following capital assets:

- a. \$16.6 million for the Taylorsville State Office Building
- b. \$19 million for the Weber State University Noorda Engineering Building
- c. \$9.0 million for the Department of Transportation West Maintenance Facility
- d. \$8.2 million for other miscellaneous capital asset projects

State policy (FIACCT 09-14.00) dictates that capitalization should occur for appropriate assets when all outstanding claims have been resolved or the building has been placed in service, whichever is earlier. Historically, DFCM and Finance have determined placement in service to be upon formal certificate of occupancy or formal certification of substantial completion. Improper capitalization/transfer of capital assets occurred because DFCM and Finance did not follow or consistently apply established capitalization policies and internal controls for yearend reporting did not prevent, detect, or correct the errors.

Failure to properly identify capitalization of assets could result in material errors in financial reporting for the State of Utah and other entities who rely on DFCM for construction.

### **Recommendation:**

**We recommend DFCM and Finance follow and consistently apply established capitalization policies. We also recommend each agency design and implement internal controls to prevent, detect, and correct errors in capitalization or the transfer of capital assets for yearend reporting.**

### *DGO's Response:*

*We agree with the findings and recommendations outlined in your Management Letter.*

### *Finance Corrective Action Plan:*

*State Finance will provide training to the capital asset accounting staff, including Division of Facilities Construction and Management (DFCM) personnel, regarding the proper recognition of capital assets. State Finance will also meet each year with DCFM to discuss the methods used to develop the schedule to ensure they are consistent with policies, procedures, and GAAP. State Finance will also review DFCM's schedule of construction projects to determine that projects are properly recorded, classified and reported.*

*Contact Person: Patricia Nelson, Assistant State Comptroller, State Division of Finance  
patriciarnelson@utah.gov*

# Department of Government Operations

Management Letter  
For the Year Ended June 30, 2021

*Anticipated Correction Date: June 30, 2022*

*Division of Facilities Construction and Management (DFCM) Corrective Action Plan:*

*Based on these findings, DFCM has already implemented the following actions to correct the noted issues; new data field in the AiM database to record the project Certificate of Occupancy date, requested a new AiM data report to be processed that will show all the CIP projects that have either a project Certificate of Substantial Completion Date of a Certificate of Occupancy to build the capitalization transfer list for that fiscal year, and created a new AiM data field in the Capital Project module to record the Certificate of Substantial Complete date for the entire project not just the construction CSC. With these three changes to our annual process, along with including the DFCM project manager in this review and sending at least two drafts to the Universities for their review of the list of projects, we believe this will improve the accuracy of the capitalization list.*

*Contact Person: David D. Williams, Finance Director, Division of Facilities Construction and Management, ddwilliams@utah.gov*

*Anticipated Correction Date: June 30, 2022*

## Finding 3. Working Capital Reserves in Excess of Federal Guidelines

Federal Agency: Various

Assistance Listing Number and Title: Various

Federal Award Number: Various

Questioned Costs: Undeterminable

Pass-through Entity: N/A

Prior Year Single Audit Report Finding Number: 2020-036; 2019-023; 2018-033; 2017-021; 2016-037; 2015-048; 2014-040; 2013-049; 2012 12-51; 2011 11-56

As of June 30, 2021, three divisions within the Department of Government Operations held working capital reserves in excess of federal guidelines as follows:

<u>Fund Description</u>	<u>Excess # of Days in Reserve</u>	<u>Excess Amount in Reserve</u>
Division of Purchasing and General Services		
Cooperative Contract Management	374	\$ 3,410,117
Federal Surplus Property	899	\$ 75,396
State Surplus Property	134	\$ 282,154
Print Services	25	\$ 72,341

# Department of Government Operations

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Division of Risk Management		
Workers' Compensation Fund	169	\$ 2,733,261
Division of Technology Services		
Printing Services	143	\$ 320,582
Communication Services	24	\$ 682,466
Network Services	16	\$ 1,040,444

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 each division within DGO 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.**

## DGO's Response:

*Annually, the Department of Government Operations (Department) analyzes reserves and estimated costs to determine a rate that reduces and minimizes excess reserves. However, these rates are determined and legislatively approved months in advance of the rate being applied and cannot be changed until the next annual rate setting cycle. Due to these timing differences, rates applied may not reflect new and unforeseen circumstances, resulting in excess or insufficient reserves. The Department makes every effort to adjust future rates to reflect changing circumstances and to minimize potential excess reserves.*

## Division of Purchasing and General Services Corrective Action Plan:

Cooperative Contract Management - Public entities in Utah rely on the Division of Purchasing and General Services (State Purchasing) to maintain the cooperative contract program to help with public procurement in Utah. The usage of state cooperative contracts by public entities increased dramatically this past year resulting in a corresponding increase in the collection of administrative fees. State Purchasing still continues to decrease the administrative fees on state cooperative contracts as each contract expires and is rebid. This is a slow process since State Purchasing has nearly 1,200 cooperative contracts that expire only every five years and are then rebid. Although State Purchasing is allowed under law to collect up to a 1.0% administrative fee on each cooperative contract, currently, the average administrative fee is 0.35 %. As a result, while spending on cooperative contracts increased 23.2% in fiscal year 2021, administrative fees increased only 14.4% during that same period.

# Department of Government Operations

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*The Division of Purchasing and General Services is also working on requesting the Utah Legislature to appropriate out a portion of excess reserves in the Cooperative Contract Management ISF in fiscal year 2023. The calculation of the federal portion of this transfer will be submitted to Cost Allocation Services for review and approval when the transfer is complete. Federal and State Surplus Property - State Surplus Property anticipates relocating by the end of fiscal year 2023 at the completion of the Utah State Prison relocation. At that time, Federal and State Surplus will use excess reserve funds to relocate and furnish the new location.*

*Print Services – Print Services has seen a dramatic decrease in usage since the start of the COVID19 pandemic, and the shift to more personnel working from home. This has resulted in another net loss year. While this was not sufficient to reduce the excess reserves to established guidelines, Print Services is continuing to experience a decrease in services provided as more employees telework, and copiers are decommissioned.*

*Contact Person: Windy Aphayrath, Director, Division of Purchasing & General Services, [waphayrath@utah.gov](mailto:waphayrath@utah.gov).*

*Anticipated Completion Date: Cooperative Contract Management – June 30, 2023; Print Services – June 30, 2022; State Surplus Property – June 30, 2023*

*Division of Risk Management Corrective Action Plan:*

*Workers' Compensation Fund – The excess reserve was caused by insurance premiums paid to the Workers' Compensation Fund of Utah (separate entity) fluctuating below expected levels this year and premiums paid in the previous year being partially refunded to the Division of Risk Management. The Division of Risk Management has also requested a rate decrease beginning July 1, 2022. In an effort to reduce the working capital reserves in this fund the Division of Risk Management has also requested a \$3 million transfer out of the Workers' Compensation Fund in fiscal year 2022. These actions are anticipated to reduce and/or eliminate the excess reserve balance in the Workers' Compensation Fund.*

*Contact Person: Brian Nelson, Director, Division of Risk Management, [benelson@utah.gov](mailto:benelson@utah.gov)  
Anticipated Correction Date: July 30, 2022*

*Division of Technology Services Corrective Action Plan:*

*Print Services – The Division of Technology Services (DTS) is moving the print operations center and associated costs from Salt Lake City to Taylorsville City. The costs associated with this move include the purchase of two new printers and the addition of two temporary staff. These costs will reduce the retained earnings. In addition, DTS has requested to set the print rate lower than the estimated costs to provide the service in both fiscal year 2022 and fiscal year 2023. This will also reduce retained earnings. DTS will annually review and adjust rates and will issue mid-year rebates if necessary to bring DTS Print Services into compliance with federal excess reserve guidelines by the end of fiscal year 2024.*

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*Communication Services - DTS also requested to set the rates in Communications Services to under recover in both fiscal year 2022 and fiscal year 2023 in an effort to reduce excess reserves. DTS has seen counts for land-line type telephone service reduce significantly in each of the past five years. DTS will annually review and adjust rates and will issue mid-year rebates if necessary to bring DTS Communication Services into compliance with federal excess reserve guidelines by the end of fiscal year 2024.*

*Network Services - This is a recurring finding which is currently partially corrected. The reason for recurrence is the network group saw a number of significant unanticipated reimbursements in fiscal year 2021 which contributed to the majority of this overage.*

*The partial corrective action taken by DTS was during the fiscal year 2022 rate setting process. DTS set rates for Network services lower than the estimated costs to provide the service by \$522,000 and DTS set rates for fiscal year 2023 lower than the estimated costs to provide the service by an additional \$346,000.*

*DTS anticipates significant expenses to this product in fiscal year 2022 and fiscal year 2023 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). Upgrades to the infrastructure have been more complex than originally estimated which has delayed the majority of this expense to fiscal year 2023. DTS will annually review and adjust rates and will issue mid-year rebates if necessary to bring DTS Network Services into compliance with federal excess reserve guidelines by the end of fiscal year 2023.*

*Contact Person: Dan Frei, Finance Director, Division of Technology Services,  
[dfrei@utah.gov](mailto:dfrei@utah.gov)*

*Anticipated Correction Date: Print Services – June 30, 2024; Communication Services – June 30, 2024; Network Services – June 30, 2023*