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UTAH STATE AUDITOR

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REPORT NO. 01-19

January 16, 2002

Ms. Raylene Ireland, Executive Director
Department of Administrative Services
3120 State Office Building
Salt Lake City, Utah 84114

Dear Ms. Ireland:

We have completed our audit of the financial statements of the State of Utah for the year ended June 30, 2001. Our report thereon, dated November 2, 2001, was issued under separate cover. We have not yet completed the Department of Administrative Services' (Administrative Services) portion of the statewide federal compliance audit for the year ended June 30, 2001. Our report on the statewide federal compliance audit for the year ended June 30, 2001 should be issued by April 2002. Any additional findings resulting from completion of the federal compliance audit will be issued to you as a supplement to this letter.

In planning and performing our audits, we considered Administrative Services' internal control over financial reporting and administration of major federal programs in order to determine our auditing procedures for the purpose of expressing our opinion on the State's financial statements and on the State's compliance with the requirements of its major programs and not to provide assurance on internal control. We noted certain matters involving Administrative Services' internal control over the administration of federal programs that we consider to be reportable conditions. These conditions are identified in the accompanying table of contents and described in the attached findings and recommendations. The reportable conditions are not believed to be material weaknesses.

Reportable conditions are defined as matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the organization's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. We have also identified as reportable conditions those instances of noncompliance that are required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States and Federal OMB Circular A-133.

During our audit, we also noted other matters involving the internal control over financial reporting and compliance of Administrative Services and its operations. We are submitting for your consideration related recommendations designed to help Administrative Services make improvements and achieve operational efficiencies. These matters are described in the attached findings and recommendations.

This report by its nature focuses on exceptions, weaknesses, and problems. This should not be understood to mean there are not also various strengths and accomplishments. Our consideration of the internal control over financial reporting and administration of federal programs would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses, particularly since our review was based on our audit of the State as a whole.

This report is intended solely for the information and use of Administrative Services and is not intended to be and should not be used by anyone other than this specified party.

We appreciate the courtesy and assistance extended to us by the personnel of Administrative Services during the course of our audit, and we look forward to a continuing professional relationship. If you have any questions, please call Stan Godfrey, Audit Director, at 538-1356.

Sincerely,

Auston G. Johnson, CPA
Utah State Auditor

COPIES SENT TO:

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Alan F. Edwards, Director
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Information Technology Services

Joe A. Jenkins, Director
Facilities Construction and Management

DEPARTMENT OF ADMINISTRATIVE SERVICES

FOR THE YEAR ENDED JUNE 30, 2001

TABLE OF CONTENTS

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2001

1. **RESERVES IN EXCESS OF FEDERAL GUIDELINES** (Reportable Condition) (Repeat Finding)

   CFDA Number and Title: **various**
   Federal Award Number: **various**
   Questioned Cost Amount: **undeterminable**
   Pass-through Entity: n/a

   The Risk Management Workers' Compensation Fund held reserves (retained earnings) in excess of federal guidelines at June 30, 2001. Federal guidelines permit internal service funds such as the Risk Management Workers' Compensation Fund to have a reasonable working capital reserve (generally no greater than 60 days of normal cash expenses). As of June 30, 2001, the Risk Management Workers' Compensation Fund retained earnings of $2,655,125 represented approximately 193 days of normal cash expenses. Excess reserves of $1,828,562 could result in a federal liability as federal programs share an interest in the reserves.

   Recommendation:

   We recommend that the Risk Management Workers' Compensation Fund eliminate excess working capital reserves through adjusting rates charged and/or making refunds.

   Administrative Service's Response:

   The Division of Risk Management agrees with this finding and is already aware of circumstances that will eliminate the excess reserves.

   The problem arises because of the long time lag between the date when rates are set and the end of the year. The division sets rates annually and collects premiums for Workers Compensation through the employee payroll system. Rates are set for each fiscal year 12 months prior to the beginning of that fiscal year, but premiums are paid by Risk Management to the Workers Compensation Fund on a calendar year basis 18 months after submission and approval of these rates.

   In a joint management decision by the Governor's Office of Planning and Budget and the Legislative Fiscal Analyst's Office, workers compensation rates have always been kept conservative and consistent from year to year, rather than setting them lower and risking a deficit or large rate increase. The budgetary and fiscal management benefits of this outweigh the occasional need to refund a surplus.

   In September 2001, Risk Management submitted a 7.5% across the board rate reduction to the Internal Service Fund rate committee. This rate reduction was approved and implemented through the state payroll system beginning in October 2001. For FY02, this will result in *approximately $324,500 reduction in retained earnings. In FY03 this reduction should reduce retained earnings by approximately $501,500.*

For calendar year 2002, the premium payable to the Workers Compensation Fund will increase by 22 percent, or $1,200,000. The increase will be paid from retained earnings rather than through a rate increase.

By the end of FY02, the retained earnings in the Workers Compensation Fund should be within the Federal guideline limits.

Contact Person: Alan F. Edwards, Director, Risk Management, (801) 538-9560

Anticipated Date of Completion: June 2002

2. **FAILURE TO INCLUDE FEDERAL REQUIREMENTS IN APPLICABLE CONTRACTS** (Reportable Condition)

Federal Agency: **U.S. Department of Defense**
CFDA Number and Title: **12.401**
Federal Award Number: **DAHA42-00-2-10011A**
Questioned Cost Amount: **undeterminable**
Pass-through Entity: n/a

One of ten contracts reviewed which were initiated during fiscal year 2001 by the Division of Facilities Construction and Management (DFCM) was 100% federally funded; however, there was no information included in the contract or project specifications requiring the contractor to certify that the organization or individual was not suspended or debarred. Per 32CFR25.200, non-federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. Failure to require contractors to make this verification is a violation of federal requirements.

Recommendation:

We recommend that DFCM ensure that federal requirements are included in all federally-funded contracts.

Administrative Service's Response:

The one contract identified by the auditors that was missing the clause containing the "suspended or debarred" language was in a National Guard contract. It is now included in all

National Guard contracts as well as any other contracts that utilize Federal funds as a funding source.

Contact Person: Joe A. Jenkins, Director, DFCM, (801) 538-3261

Anticipate Date of Completion: January 2002

3. FAILURE TO RETAIN THE PROPER PERCENTAGE OF CONTRACT AMOUNTS UNTIL PROJECT COMPLETION

DFCM failed to retain 5% of the contract amount when making payments for 3 of the 25 projects tested. The difference between what should have been retained and the actual amount retained for these contracts totaled $410,056. The DFCM contract for each of these projects states that the contractor will be paid up to 95% of the contract amount while work is in progress and that the remaining 5% will be retained by DFCM until the project is substantially complete. Withholding less than 5% of the contract amount results in noncompliance with the contract provisions and increases the State's risk if the project is not completed.

Recommendation:

We recommend that DFCM follow the provisions of the contract by retaining the proper percentage of the contract amount until all work has been completed.

Administrative Service's Response:

DFCM will establish a system to ensure that the proper percentage is retained from contract amounts as stated in the contract documents.

4. TRANSACTIONS RECORDED IN THE IMPROPER YEAR

We tested a statewide sample of 66 fiscal year 2002 expenditure transactions that were recorded in July and August of 2001 and noted four transactions within the Department of Administrative Services that should have been recorded in fiscal year 2001. One error in the amount of $4,320 occurred at the Division of Information Technology Services. The remaining three errors, amounting to $186,660, occurred at DFCM. All three DFCM errors related to construction payments for work that spanned two fiscal years; however, the entire payment was recorded in fiscal year 2002, rather than being properly allocated between fiscal years 2001 and 2002. Expanded testwork in the area of construction payments at DFCM revealed two additional errors, for a total of five errors amounting to $570,709. If transactions are not recorded in the proper year, expense and liability balances at year end will be misstated.

In addition, the Department of Administrative Services should develop policies that give guidance to agencies on how to record payments that involve more than one fiscal year, such as construction costs, subscriptions, membership dues, etc. This guidance should include how to treat small, recurring transactions for which the cost of splitting the transaction into two fiscal years may outweigh the benefits, as well as large construction payments that should be split between years. This guidance should also address the dollar amount agencies should use in determining when to split these transactions between two fiscal years.

Recommendation:

We recommend that the Department of Administrative Services develop policies to guide agencies in recording transactions that span two fiscal years. We also recommend that the Department record transactions in the proper fiscal year, in accordance with this policy, to ensure accuracy in financial reporting.

Administrative Service's Response:

Administrative Services agrees with the findings and recommendation. The Division of Finance will develop general policies that can be followed by DFCM and other agencies when recording transactions that span two fiscal years, and that takes small, recurring expenditures into account.

5. FAILURE TO FOLLOW LEASE POLICY IN AMENDING LEASE TERMS

During our testwork of amended leases, we noted that DFCM does not document that they have followed division policy in "seeking comparable lease rates of like facilities in the same area to determine the market value of the existing space" as required by DFCM Policy Section IV.F and *Utah Code* 63A-5-302(1)(e). Determining and documenting market value of existing lease space is important in negotiating a reasonable price for the amended lease terms and is also required by law.

Reccomendation:

We recommend that DFCM document their analysis of comparable lease rates to show they have followed division leasing policy and *Utah Code* when negotiating market rates for amended lease terms.

Administrative Service's Response:

DFCM has reviewed the completed files for the Amended leases that were included in the audit. They found the required information in several of the files, but the information that is required *by Policy and Code was not in all the files. In the files that we found the information, the information was on the correspondence side of the file, and not directly behind the lease. They have standardized the form that this information will be collected on and the location in the file where the form will be maintained. We believe that these actions will correct this issue in the future.*

6. LACK OF APPROVAL FORM FOR DISPOSALS OF FIXED ASSETS

We identified two fixed asset disposals (one from the Division of Fleet Operations and one from the Division of Information Technology Services) that lacked properly approved Declaration of Surplus Property forms (SP-1). State Accounting Policies and Procedures (FIACCT 09-02.10) require "the declaration of property as surplus to be authorized by the agency head or authorized agent" as documented on form SP-1. Without the proper authorization, agencies are at a greater risk of improper asset disposals.

Recommendation:

We recommend that the Division of Fleet Operations and the Division of Information Technology Services document the disposal of fixed assets with a properly approved SP-1 form in accordance with State policies and procedures.

Administrative Service's Response:

The Division of Fleet Operations and the Division of Information Technology Services agree with the Auditor's recommendation and will provide completed SP-1s upon disposal of assets.

7. IMPROPER POST AUDIT FOLLOW-UP PROCEDURES

The State Division of Finance (Finance) did not perform proper follow-up procedures on their post audit testwork. We noted one transaction processed by the Utah National Guard where an expenditure was coded to the improper object code. The error was identified by Finance on October 25, 2000; however, as of the date of our testwork (August 20, 2001) the error had not been corrected by the National Guard. According to Finance's Mini-Policy and Procedure Guide, section I.A. "Auditing Payment Documents," the post auditors are to follow up on all detected errors within 15 working days and review the agency's response to the audit finding. If the response is not satisfactory, Finance should continue to work with the agency until the errors are resolved. If proper follow-up procedures are not performed, errors may go uncorrected and reliance on post audit procedures for financial reporting purposes may be affected.

Recommendation:

We recommend that Finance perform proper follow-up procedures on all errors identified by post audit.

Administrative Service's Response:

The Division of Finance agrees with the finding. The Division has already hired an individual to perform an operational review and analysis of the post-audit functions. Included in this review is a system to identify and implement proper follow-up procedures on all errors identified by post audit.