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UTAH STATE AUDITOR

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REPORT NO. 03-18

January 15, 2004

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

Dear Ms. Anthony:

We have completed our audit of the financial statements of the State of Utah for the year ended June 30, 2003. Our report thereon, dated October 31, 2003, was issued under separate cover. We have not yet completed the Department of Administrative Services' (the Department's) portion of the statewide federal compliance audit for the year ended June 30, 2003. Our report on the statewide federal compliance audit for the year ended June 30, 2003 should be issued by April 2004. Any additional findings resulting from the 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 the Department's 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 the Department's internal control over financial reporting and administration of federal programs that we consider to be reportable conditions. These conditions are identified in the accompanying table of contents and are described in the accompanying schedule of findings and recommendations. These 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 financial reporting and compliance that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements or 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 the Department and its operations. We are submitting for your consideration related recommendations designed to help the Department make improvements and achieve operational efficiencies. These matters are described in the accompanying schedule of 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 the Department 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 the Department 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 (801) 538-1356.

Sincerely,

Auston G. Johnson, CPA
Utah State Auditor

cc: Kim S. Thorne, Director, DAS Division of Finance
Lynn H. Vellinga, Assistant Director, DAS Division of Finance
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DEPARTMENT OF ADMINISTRATIVE SERVICES
FOR THE YEAR ENDED JUNE 30, 2003

TABLE OF CONTENTS

	<u>Page</u>
FINDINGS AND RECOMMENDATIONS:	
1. INADEQUATE IMPLEMENTATION OF POLICY FOR THE NEW SAP PAYROLL SYSTEM (Reportable Condition)	1
2. RESERVES IN EXCESS OF FEDERAL GUIDELINES (Reportable Condition)	2
3. EXPENDITURE CUT-OFF ERROR	3
4. INCOMPLETE ACCOUNTING RECORDS FOR PUNITIVE DAMAGES ACCOUNTS RECEIVABLE	4
5. OVERPAYMENT OF LIFE INSURANCE PREMIUMS FOR MERIT EXEMPT EMPLOYEES	5
6. NONCOMPLIANCE WITH STATE CAPITAL ASSET POLICIES	5

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

1. **INADEQUATE IMPLEMENTATION OF POLICY FOR THE NEW SAP PAYROLL SYSTEM** (Reportable Condition)

As part of the implementation of the new SAP Payroll System (the System), the Division of Finance (Finance) developed a new *Payroll Review and Approval Process* policy (the policy). This policy requires State agencies to generate, review, approve, and retain certain payroll reports to ensure the accuracy of the payroll transactions entered into the System. However, the policy was not finalized and adequately communicated to agencies until after the implementation of the System. Because of the confusion at various agencies regarding the requirements of the policy, we found noncompliance with the policy in 24 of 40 payroll expenditure transactions tested. The 40 transactions were processed by 17 different agencies.

Eleven of the 17 agencies tested were unable to provide us with copies of one or more required reports or they generated the reports when we requested them. Three of the 11 agencies that retained some of the required reports could not provide evidence to show that the reports had been reviewed and approved. One agency retained the last page of some of the reports but was unable to provide copies of the corresponding cover sheets to us. Two agencies generated one or more reports in August 2003 after we requested them rather than at the time they were supposed to be generated and reviewed. Each pay period, agencies should generate, review, approve, and retain required reports to document that payroll transactions entered into the System are accurate and approved.

Since the new *Payroll Review and Approval Process* policy is a significant control to ensure that payroll data is properly entered into the System, noncompliance with the policy could allow errors or misappropriations related to payroll expenditures to occur without detection.

Recommendation:

We recommend that Finance communicate the importance of their new *Payroll Review and Approval Process* policy to all agencies and monitor agencies to ensure that they comply with the policy.

Administrative Services' Response:

Corrective Action: With the implementation of a new payroll system in March, new processes and policies for review and approval of payroll were established by State Finance. A new policy, FIACCT 11-17.00, was issued March 3, 2003 and further clarified and updated July 1, 2003. This new policy outlined the required reports and review process to be followed by agencies each pay period. Articles discussing these new processes were included in Finance's monthly publication, *FineLine*, in March and June 2003. An e-mail message with the payroll approval policy attached was sent to all the state employees responsible for payroll processing on August 21, 2003 and Finance discussed the new policy and procedures in the Budget and

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

Accounting Officers Meeting on March 25, 2003 and again in the Agency Coordinating Team (ACT) meeting on May 14, 2003.

Finance will continue to remind agency management of the importance of review and approval of these payroll reports. The January 2004 FineLine has a lead article that discusses the importance of the Payroll Review and Approval Process policy. Finance will also discuss this issue with the Governor's Cabinet in their next meeting and stress the importance of compliance with this policy.

Anticipated Correction Date: January 14, 2004, the anticipated date of the next Cabinet meeting.

Contact Person: Kim Thorne (801) 538-3095

2. **RESERVES IN EXCESS OF FEDERAL GUIDELINES** (Reportable Condition)

The Risk Management Fund held working capital reserves in excess of federal guidelines at June 30, 2003. Federal Guidelines permit internal service funds such as Risk Management to have a reasonable working capital reserve (generally no more than 60 days of normal cash expenses). As of June 30, 2003, the Risk Management Fund working capital reserves of \$7.1 million represented approximately 88 days of normal cash expenses. A portion of the \$2.2 million excess working capital reserves may be subject to a federal liability as federal programs share an interest in the reserves.

Recommendation:

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

Administrative Services' Response:

Corrective Action: Risk Management has been working with the federal negotiator for Utah's Statewide Cost Allocation Plan on excess reserves related to workers compensation. They anticipate that the excess workers compensation reserves will be eliminated by June 30, 2004 through net operating losses.

At the request of the federal negotiator, in fiscal year 2003, Risk Management began to account for property, auto, and general liability as three separate coverage programs rather than a combined program. At June 30, 2003, both the property and general liability programs had reserves in excess of federal guidelines. Risk Management will review rates and projected costs and set up a plan to come into compliance with the federal guidelines. They anticipate a two to

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

three year timeframe to come into compliance. This plan will be submitted to the federal negotiator and the federal negotiator will decide whether any refund is necessary. The Division estimates that the federal portion of the property and general liability reserves is approximately 11 percent.

Anticipated Correction Date: June 30, 2004 for workers compensation reserves; June 30, 2006 for other reserves.

Contact Person: Bob Wylie, Accountant, (801) 538-9560

3. **EXPENDITURE CUT-OFF ERROR**

We reviewed two Capital Projects Fund expenditure transactions and noted one expenditure of \$4,811,882 that was recorded by Finance in fiscal year 2004 for construction costs that were incurred in fiscal year 2003. The construction of the Huntsman Cancer Center at the University of Utah (the University) has been delegated to the University by the Division of Facilities Construction & Management (DFCM). The University is reimbursed for construction costs from the proceeds of the 2001A Lease Revenue Bonds issued by the State. The University submitted a reimbursement request to the bond trustee on July 22, 2003. DFCM also received a copy of this reimbursement request along with copies of the associated invoices. The trustee made a wire transfer of \$4,811,882 to the University on July 28, 2003. When Finance received the bond trustee statement for the month of July, they erroneously recorded the expenditure in fiscal year 2004 because the bond trustee statement does not provide enough detail to determine when underlying expenditures were incurred. To ensure that expenditures are recorded in the correct fiscal year, Finance should consult with DFCM. As a result of our audit, Finance recorded an accrual for these expenditures in fiscal year 2003.

Recommendation:

We recommend that Finance consult with DFCM to ensure that these construction transactions are recorded in the correct fiscal year.

Administrative Services' Response:

We concur. In the future, in those limited instances where the Division of Finance records construction expenditures from trustee statements, they will work with DFCM to ensure the expenditures are recorded in the correct fiscal year.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

4. **INCOMPLETE ACCOUNTING RECORDS FOR PUNITIVE DAMAGES ACCOUNTS RECEIVABLE**

At the end of fiscal year 2003, Finance concluded that there were no collectible accounts receivable for punitive damage cases; however, there was not a complete list of these cases upon which to calculate a receivable or provide support for Finance's conclusion. During fiscal year 2002, the State began tracking and attempting collection on punitive damage awards pursuant to *Utah Code*, Section 78-18-1. The *Utah Code* does not designate which agency is responsible for maintaining documentation sufficient to determine the year-end receivable balance; however, it would seem to fall within Finance's responsibilities to ensure that such documentation exists and supports their conclusion.

While the Administrative Office of the Courts and the Attorney General's Office have been working in cooperation to identify cases and file a notice with the courts of the State's interest in the cases, there is no agency currently working to track the collection status of these cases. We noted that the Attorney General's Office did not have a complete list of all relevant punitive damage award cases that were identified in fiscal years 2001 and 2002, and the listing provided to us by the Courts of fiscal year 2003 punitive damage awards was missing one case that had been identified at the Attorney General's Office.

A complete list of punitive damage cases should be maintained, including the current collection status, to enable Finance to determine whether the State has a receivable that should be reported in the financial statements. These records should also be maintained to justify the total dollar amount of receivables, including records that support allowances or write-offs.

Recommendation:

We recommend that Finance work with the Administrative Office of the Courts and the Attorney General's Office to maintain a complete list of punitive damage cases. We also recommend that Finance maintain adequate documentation at year end to support their calculation of punitive damages accounts receivable and any related allowance for uncollectible amounts.

Administrative Services' Response:

We concur. It is State Finance's understanding that the Attorney General's Office has taken the lead role in collecting and tracking the State's portion of punitive damage awards. The Attorney General's Office now provides monthly reports of these cases and their collection status to the State Treasurer and other interested parties. To date, state revenues from punitive damage awards have been immaterial and the likelihood of receiving revenues in most of these cases is remote. Nevertheless, in the future the Division of Finance will use the listings

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

provided by the Attorney General and other information as necessary to support the calculation of punitive damages accounts receivable and any related allowance for uncollectible amounts. State Finance has also been informed that the Administrative Office of the Courts has procedures to notify the Attorney General's Office and the State Treasurer of all punitive damage awards.

5. OVERPAYMENT OF LIFE INSURANCE PREMIUMS FOR MERIT EXEMPT EMPLOYEES

Our testing of payroll benefit calculations identified an instance where the State overpaid \$32 for life insurance benefits for a merit exempt employee. Although merit exempt employees are eligible to receive additional State-paid life insurance benefits, the employee we selected only qualified for a reduced amount of coverage due to underwriting concerns. The overpayment occurred because the new Payroll System was not programmed to calculate a reduced premium for merit exempt employees who either do not qualify for the full amount of coverage or decline all of the additional coverage. As a result, the system overpays the life insurance premiums for these employees. Based on data received from Public Employees Health Program (PEHP), 85 employees declined coverage or only qualified for reduced coverage due to underwriting concerns. PEHP estimated the overpayment of premiums by the State for these 85 employees to be approximately \$19,008 per year.

Recommendation:

We recommend that Finance program the new Payroll System to correctly calculate life insurance premiums for all merit exempt employees. We also recommend that Finance request a refund of the overpaid premiums from PEHP.

Administrative Services' Response:

During the initial design of the new payroll system it was determined that three different life insurance coverage options for merit exempt employees needed to be set up. Soon after the system was implemented it was brought to State Finance's attention that some merit exempt employees were allowed to have different levels of insurance coverage than were originally set up in the new system. This resulted in some overpayments. State Finance expects to have the additional coverage levels functional in the system by the end of January, 2004 and they will be working with PEHP to obtain a refund of the differences.

6. NONCOMPLIANCE WITH STATE CAPITAL ASSET POLICIES

During our review of the internal service funds' capital assets, we noted the following:

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

- a. Assets under the \$5,000 capitalization limit, excluding betterments, have been capitalized and depreciated by the internal service funds. Finance policy FIACCT 12-04.00 requires that assets with a cost of less than \$5,000, excluding betterments, be expensed when purchased. Internal service funds may request an exception to this capitalization limit through the Director of Finance; however, Copy Services (part of General Services) is the only fund that has requested and been granted this exception. All internal service funds should capitalize only those assets with a cost greater than or equal to \$5,000 or request an exception to this limit from the Director of Finance. Using various capitalization limits results in the State's financial statements containing inconsistencies and may mislead users of the statements.

Recommendation:

We recommend that the internal service funds either follow state policy by capitalizing and depreciating only those assets with a cost of \$5,000 or greater (excluding betterments) or obtain approval from the Director of Finance to use a lower capitalization limit.

- b. In 1 out of 6 capital asset additions tested (16.6%), an asset was added to the internal service fund's fixed asset listing net of the trade-in value. Finance policy FIACCT 09-01.00 requires that assets received in an exchange (trade-in) be recorded at their fair market value. By netting the cost of the asset with the value of a trade-in, capital asset values may be understated in the financial statements.

Recommendation:

We recommend that the internal service funds follow state policy by recording all assets received in an exchange (trade-in) at their fair market value.

- c. In 1 out of 6 capital asset deletions tested (16.6%), an internal service fund continued depreciating an asset after it was destroyed in a fire. Finance policy FIACCT 09-10.00 indicates that it is the responsibility of an agency to dispose, cancel, and delete fixed asset records if an asset has been lost, stolen, destroyed, scrapped, or sold. Leaving an asset on the records after it has been destroyed overstates the agency's assets, accumulated depreciation, and depreciation expense.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2003

Recommendation:

We recommend that the internal service funds remove assets from their fixed asset listing when they are lost, stolen, destroyed, scrapped, or sold, as required by State policy.

- d. In 1 out of 6 capital asset deletions tested (16.6%), an internal service fund did not record a gain on the trade-in of a fully depreciated asset. When an asset is disposed of, a gain or loss should be recorded equal to the difference between the asset's carrying value and the value received through the disposal. By not recording the gain on the sale of fixed assets, the State's financial statements may be understated.

Recommendation:

We recommend that the internal service funds properly account for any gains or losses on the disposal of their fixed assets.

Administrative Services' Response:

The findings and recommendations related to state Capital Asset Policies were discussed with all of the Internal Service Fund lead accounting personnel. The Division of Finance and the Internal Service Funds will work together to ensure that capital assets are properly accounted for in accordance with state policies.