



DEPARTMENT OF ADMINISTRATIVE SERVICES

Management Letter
For the Year Ended June 30, 2007

Report No. 07-19

*Keeping Utah
Financially Strong*

AUSTON G. JOHNSON, CPA
UTAH STATE AUDITOR



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REPORT NO. 07-19

January 2, 2008

Kimberly Hood, Executive Director
Department of Administrative Services
3120 State Office Building
Salt Lake City, Utah 84114

Dear Ms. Hood:

We have completed our audit of the financial statements of the State of Utah as of and for the year ended June 30, 2007 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 report thereon, dated November 20, 2007, is issued under separate cover. We have not yet completed the statewide federal compliance audit for the year ended June 30, 2007. Our report on the statewide federal compliance audit for the year ended June 30, 2007 should be issued in January 2008. Any additional findings relating to the Department of Administrative Services (the Department) which result from the completion of the federal compliance audit will be issued to you as a supplement to this letter.

In planning and performing our audit we considered the Department's internal control over financial reporting and compliance as a basis for designing our auditing procedures for the purpose of expressing our opinions on the State's financial statements and on the State's compliance with the requirements of its major programs, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies, two of which we consider to be material weaknesses. These deficiencies are identified in the accompanying table of contents and are described in the accompanying schedule of findings and recommendations.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements or noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to 1) initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles or 2) administer a federal program such that there is more than a remote likelihood that a misstatement of the entity's financial statements or that noncompliance with a type of compliance requirement of a federal program that are more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements or that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

This communication is intended solely for the information and use of management and others within the Department and is not intended to be and should not be used by anyone other than these specified parties. However, the report is a matter of public record and its distribution is not limited.

The Department's written responses to the findings and recommendations identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 Joe Christensen, Deputy State Auditor, at (801) 538-1354.

Sincerely,

Auston G. Johnson, CPA
Utah State Auditor

cc: John C. Reidhead, CPA, Director, State Division of Finance

DEPARTMENT OF ADMINISTRATIVE SERVICES
FOR THE YEAR ENDED JUNE 30, 2007

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Finding Type:

MW Material Internal Control Weakness
SD Significant Deficiency of Internal Control

Applicable To:

s State Financial Statements
f Federal Program

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

1. **INADEQUATE INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Federal Agency: N/A

CFDA Number and Title: N/A

Federal Award Number: N/A

Questioned Costs: N/A

Pass-through Entity: N/A

The State did not have adequate internal controls to ensure that all transactions were properly captured and recorded in the appropriate fiscal year and that the financial statements were properly prepared in accordance with generally accepted accounting principles. As a result, significant audit adjustments were required to properly present the State's financial activities in the *Comprehensive Annual Financial Report (CAFR)*.

Management is responsible for the preparation and accuracy of the *CAFR* and for establishing internal controls and procedures to accurately capture and record transactions.

Recommendation:

We recommend that the State Division of Finance establish internal controls to ensure the *CAFR* properly presents the State's financial activities in conformity with generally accepted accounting principles and that transactions are captured and recorded in the proper accounting period.

Agency's Response:

*We agree with the finding and recommendation. The Division of Finance will continue to improve its internal controls established to accurately capture and record transactions. As part of this effort, we will follow up on all audit adjustments to help ensure that the underlying problems are resolved. Various factors such as the diversity of the sources and types of information summarized for presentation in the *CAFR*, as well as the timing of the audit procedures make it difficult for any control in this area to completely eliminate audit adjustments. However, we are committed to maintaining sound internal controls in order to keep the number of audit adjustments to a minimum.*

Contact Person: Marcie Handy, Assistant State Comptroller, (801) 538-1678

Correction Date: June 2008

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

2. **INADEQUATE INTERNAL CONTROLS OVER SIGNIFICANT ACCOUNTING ESTIMATES**

Federal Agency: N/A

CFDA Number and Title: N/A

Federal Award Number: N/A

Questioned Costs: N/A

Pass-through Entity: N/A

The Tax Commission and the State Division of Finance do not have adequate internal controls to ensure that significant accounting estimates, such as the estimates for the May and June tax assessments and the income tax final payment accruals, are appropriate and reasonable. Management is responsible for the fair presentation of its activities and balances in the annual financial statements. This includes responsibility for the accounting estimates included in the financial statements and appropriate internal controls over those accounting estimates.

The Tax Commission and the State Division of Finance have jointly determined the methods for calculating the relevant accounting estimates related to taxes for the financial statements. The Tax Commission provides data to the State Division of Finance who then uses the data to prepare accounting estimates that are included in the financial statements. The State Division of Finance contacts the Tax Commission if there are questions about the accuracy and reasonableness of information provided. However, the Tax Commission is not involved in the review or approval of the final estimates. Also, there are no documented reviews or comparisons of the estimates to the subsequent actual results by either the State Division of Finance or the Tax Commission.

Due to the lack of internal controls, the May and June tax assessments (which were originally estimated at \$169 million) were overstated by \$83 million in total and resulted in audit adjustments to three different funds in the financial statements. Also, even though the final payment accrual estimated at \$306 million for fiscal year 2007 was deemed appropriate, we feel the internal controls over this estimate should be improved to prevent errors or misstatements in future years.

Recommendation:

We recommend that the Tax Commission and the State Division of Finance work together to ensure that there are adequate internal controls over significant accounting estimates, including appropriate review and documented approval of such estimates by both the State Division of Finance and the Tax Commission. We also recommend that either the State Division of Finance or the Tax Commission annually prepare a comparison of significant estimates to subsequent actual results.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

Agency's Response:

The Tax Commission and the Division of Finance concur with the recommendation that we review and document approval of accounting estimates and compare estimates to subsequent actual results. We will work together to evaluate the current internal controls and methodologies for accounting estimates and will establish new methodologies as necessary to enhance the existing reporting.

*Contact Person: Marcie Handy, Assistant State Comptroller, (801)538-1678
Anticipated Correction Date: June 30, 2008*

3. **FINET TRANSACTIONS PROCESSED WITHOUT REQUIRED APPROVALS**

Federal Agency: **various**
CFDA Number and Title: **various**
Federal Agency: **various**
Federal Award Number: **various**
Questioned Costs: **N/A**
Pass-through Entity: **N/A**

We identified several transactions that were processed through FINET without the required approvals. The transactions processed included general accounting expenditures, commodity-based payment requests, and journal vouchers. This problem was the result of workflow approval rules that were setup incorrectly in the system by the State Division of Finance. Without proper transaction approvals, the risk of errors, misappropriations, or fraud increases.

Recommendation:

We recommend that the State Division of Finance establish controls to ensure that all transactions are properly approved before being processed through the FINET system.

Agency's Response:

The transactions identified in the audit finding occurred when the new FINET accounting system was first implemented in July 2006. The problems were isolated to very few individuals and resulted from incomplete set up of security and workflow rules for those individuals. To tighten controls, the Division has created a system query/report to be run and reviewed daily by the FINET security administrator to ensure that any new documents processed without approval are discovered and their associated workflow rules modified immediately to eliminate the problem. We are also working with the applicable agencies to have the transactions that processed without the required approvals reviewed for validity.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

*Contact Person: Jerry Gearheart, Financial Information Systems Manager, (801) 538-1023
Correction Date: December 2007*

4. INADEQUATE CONTROLS OVER STATEWIDE PAYROLL EXPENDITURES

Federal Agency: **various**
Federal Award Number: **various**
CFDA Number and Title: **various**
Questioned Costs: **N/A**
Pass-through Entity: **N/A**

Controls established by the State Division of Finance are inadequate to prevent or detect inappropriate payroll transactions.

In fiscal year 2003, the State Division of Finance implemented a new payroll system. This system (SAP), as implemented, did not require approval of payroll transactions entered into the system before the transactions were posted to the general ledger. In light of this weakness, the State Division of Finance implemented controls, consisting of reviewing various summary reports during and after the payroll entry process to ensure that the payroll transactions that would be processed were reviewed by an independent, authorized individual. However, during our review of controls over payroll expenditures from fiscal year 2004 to the present, we have noted significant deficiencies of internal controls at various State entities reflecting their inability or unwillingness to implement the established controls.

These failures in controls are mainly created by two circumstances: 1) the individual reviewing the summary payroll reports also has the ability to post transactions to the payroll system, thus allowing them to enter transactions into the payroll system without detection (resulting in Separation of Duties findings to several agencies), and 2) the required reports have not been reviewed and/or retained by the department (resulting in Noncompliance with Payroll Policy findings to several agencies).

As a result of these control deficiencies there is an increased risk of errors or misappropriations occurring without detection.

Recommendation:

We recommend that the State Division of Finance design control procedures that will ensure that all payroll transactions are adequately reviewed and approved and that payroll entry and review responsibilities are properly separated.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

Agency's Response:

We agree with the finding and recommendation. We have reviewed various options for eliminating the control deficiencies mentioned in the finding and we plan to implement one of the options in the next few months. However, we also want to point out that agencies' compliance with our control requirement that they review various SAP summary reports has progressively improved since the system was implemented in 2003.

Contact Person: Mark Austin, State Payroll Manager, (801) 538-3023

Correction Date: April 2008

5. INADEQUATE CONTROLS OVER CAPITAL ASSET ADDITIONS

Federal Agency: N/A

CFDA Number and Title: N/A

Federal Award Number: N/A

Questioned Costs: N/A

Pass-through Entity: N/A

We noted the following deficiencies related to capital assets internal controls:

- a. We reviewed five Fixed Asset Reconciliation Worksheets and noted that the reconciliation for the Department of Transportation was filled out incorrectly, resulting in \$2.63 million of asset additions not being reported in the State's financial statements. In addition, the reconciliation for the Division of Facilities Construction and Management was not performed until after we requested it. Reconciliations of the capital outlay expenditures to the fixed asset activity should be performed correctly and in a timely manner in order to identify and correct errors. Incorrect or untimely reconciliations could allow errors in capital asset records and the State's financial statements to go undetected.
- b. There are not adequate internal controls to ensure that as construction of capital assets is completed and removed from construction in progress (CIP), it is also recorded as an addition to the appropriate Capital Asset category. We reviewed CIP deletions (Completed Capital Assets) and noted approximately \$11.98 million of deletions for the Department of Natural Resources that should have also been recorded as "capital asset additions" but were not. As a result, Capital Assets were not properly reported in the State's financial statements.

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2007

Recommendation:

We recommend that the State Division of Finance establish internal controls to ensure that:

- a. Fixed asset reconciliation worksheets are properly completed by state agencies in a timely manner.**
- b. CIP deletions and capital asset additions are accounted for appropriately in the State's accounting system and financial statements.**

Agency's Response:

We agree with the finding and recommendation. We will work with agencies to ensure fixed asset reconciliation worksheets are properly completed and submitted timely. We will also strengthen our internal controls to ensure that capital asset additions and construction in progress deletions are properly reported in the State's financial statements.

*Contact Person: Marcie Handy, Assistant State Comptroller, (801) 538-1678
Correction Date: January 2008*