



DEPARTMENT OF ADMINISTRATIVE SERVICES

Management Letter
For the Year Ended June 30, 2008

Report No. 08-20

*Keeping Utah
Financially Strong*

AUSTON G. JOHNSON, CPA
UTAH STATE AUDITOR



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MANAGEMENT LETTER NO. 08-20

February 2, 2009

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, 2008 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 December 4, 2008, is issued under separate cover. We have also completed the statewide federal compliance audit for the year ended June 30, 2008. Our report on the statewide federal compliance audit for the year ended June 30, 2008 should be issued in February 2009.

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 or material weaknesses. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies, one of which we consider to be a material weakness. 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.

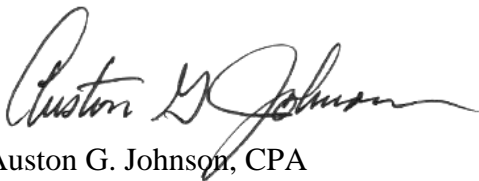
During our audit, we also noted another matter involving internal control deficiencies and noncompliance. We are submitting for your consideration a related recommendation designed to help the Department make improvements and achieve operational efficiencies. This matter is described in the accompanying schedule of findings and recommendations.

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,

A handwritten signature in black ink that reads "Auston G. Johnson". The signature is fluid and cursive, with the first name being the most prominent.

Auston G. Johnson, CPA
Utah State Auditor

cc: John C. Reidhead, CPA, Director, State Division of Finance
Marcie Handy, Assistant Controller, State Division of Finance
Roger Livingston, Director, Division of Risk Management

DEPARTMENT OF ADMINISTRATIVE SERVICES
FOR THE YEAR ENDED JUNE 30, 2008

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Finding Type:

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

Applicable To:

s State Financial Statements
f Federal Program

DEPARTMENT OF ADMINISTRATIVE SERVICES

FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2008

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 does not have adequate internal controls to ensure that all transactions are properly captured and recorded in the general ledger and that the financial statements are 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 transactions are properly captured and recorded in the general ledger and the *CAFR* properly presents the State's financial activities in conformity with generally accepted accounting principles.

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
Anticipated Correction Date: June 2009

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FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2008

2. **INADEQUATE CONTROLS OVER STATEWIDE PAYROLL EXPENDITURES**

Federal Agency: **various**
CFDA Number and Title: **various**
Federal Award Number: **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 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.

Agency's Response:

We agree with the finding and recommendation. We are currently implementing a new system control that will no longer allow automatic processing of payroll transactions. The new control will require a manager or supervisor, other than the time entry operator, to review and approve

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FINDINGS AND RECOMMENDATIONS FOR THE YEAR ENDED JUNE 30, 2008

payroll entries, prior to the transactions processing. This control will be phased in over the 2009 calendar year. Once this control is fully functional, the review of various summary payroll reports will be an optional control.

*Contact Person: Mark Austin, State Payroll Manager, (801) 538-3023
Anticipated Correction Date: December 2009*

3. **RESERVES IN EXCESS OF FEDERAL GUIDELINES**

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

The Division of Risk Management held working capital reserves in excess of federal guidelines at June 30, 2008 in the Risk Management Internal Service Funds (ISFs). Federal guidelines permit a reasonable working capital reserve of no more than 60 days for all funds that comprise the Risk Management ISFs. As of June 30, 2008, the Risk Management ISFs had total working capital reserves of \$11.1 million represented approximately 131 days of normal cash expenses. Excess working capital reserves, netting to \$5.5 million for the Risk Management ISFs, could result in a federal liability since federal programs share an interest in the reserves.

Recommendation:

We recommend that the Division of Risk Management eliminate working capital reserves in the Risk Management Internal Service Funds.

Agency's Response:

We agree with the finding and recommendation. We are in the process of reducing these excess reserves through rate reductions and appropriation transfers out. Costs are also expected to increase during the next fiscal year which will further reduce the excess reserves.

*Contact Person: Roger Livingston, Director of Risk Management, (801) 538-9560
Anticipated Correction Date: June 2009*