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David A. Vaudt, CPA
Auditor of State

NEWS RELEASE

FOR RELEASE August 31, 2006

Contact: Andy Nielsen
515/281-5834

Auditor of State David A. Vaudt today released a report on the Iowa Department of Administrative Services for the year ended June 30, 2005.

The Iowa Department of Administrative Services is mandated by statute to provide services for other state agencies. To fulfill this responsibility, the Department is structured into the General Services Enterprise (GSE), the Information Technology Enterprise (ITE), the Human Resources Enterprise (HRE) and the State Accounting Enterprise (SAE).

Vaudt recommended the Department develop procedures to strengthen controls over payroll and inventory and maintain documentation which supports billing rates for utility services. In addition, the Department should perform timely reconciliations for capital assets, risk financing and motor pool operations and take steps to resolve/correct variances noted. The Department's responses are included in the report.

A copy of the report is available for review in the Iowa Department of Administrative Services, in the Office of Auditor of State and on the Auditor of State's web site at http://auditor.iowa.gov/reports/reports.htm.

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REPORT OF RECOMMENDATIONS TO THE IOWA DEPARTMENT OF ADMINISTRATIVE SERVICES

JUNE 30, 2005

Office of
AUDITOR OF STATE
State Capitol Building • Des Moines, Iowa

David A. Vaudt, CPA
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David A. Vaudt, CPA
Auditor of State

August 24, 2006

To Mollie Anderson, Director of the
Iowa Department of Administrative Services:

The Iowa Department of Administrative Services is a part of the State of Iowa and, as such, has been included in our audits of the State's Comprehensive Annual Financial Report (CAFR) and the State's Single Audit Report for the year ended June 30, 2005.

In conducting our audits, we became aware of certain aspects concerning the Department's operations for which we believe corrective action is necessary. As a result, we have developed recommendations which are reported on the following pages. We believe you should be aware of these recommendations which pertain to the Department's internal control, compliance with statutory requirements and other matters. These recommendations have been discussed with Department personnel and their responses to these recommendations are included in this report.

This report, a public record by law, is intended solely for the information and use of the officials and employees of the Department, citizens of the State of Iowa and other parties to whom the Department may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the Department during the course of our audits. Should you have questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience. Individuals who participated in our audits of the Department are listed on page 15 and they are available to discuss these matters with you.

DAVID A. VAUDT, CPA	WARREN G. JENKINS, CPA
Auditor of State	Chief Deputy Auditor of State

cc: Honorable Thomas J. Vilsack, Governor
Michael L. Tramontina, Director, Department of Management
Dennis C. Prouty, Director, Legislative Services Agency

Findings Reported in the State's Single Audit Report:

No matters were noted.

Findings Related to Internal Control:

(1) Inventory Control Procedures – During our review of internal control, the existing procedures are evaluated in order to determine incompatible duties, from a control standpoint, are not performed by the same employee. This segregation of duties helps to prevent losses from employee error or dishonesty and, therefore, maximizes the accuracy of the Department's inventory records. The following conditions were noted:

(a) The Vehicle Dispatcher maintains a vehicle parts inventory for routine maintenance and repair and the Information Technology Enterprise maintains stock inventory for data processing systems. The employees responsible for this inventory order, receive and store the inventory. They also update the inventory records.

(b) All printing personnel have access to the printing inventory stored at the Grimes State Office Building.

Recommendation – The Department should implement procedures to segregate the purchasing, receiving, recording and custody functions for inventory to help safeguard inventory. In addition, the Department should restrict access to printing inventory.

Response – With regard to item (a) above, the State Garage has implemented a parts ordering/receipt system to respond to this concern. The Purchasing Agent fills the order request for the parts required and sends to the Garage Supervisor for approval (via signature or initial). After approval, the Purchasing Agent orders parts from the parts vendors. When parts are received, a Mechanic verifies parts received (via signature or initial) and that the order is complete. The Purchasing Agent puts the parts on the inventory system. The Fleet Administrator approves (via signature or initial) the invoice before it is sent to DAS Finance for payment.

Also, in August 2005, the procedures for ordering data processing supplies for the Information Technology Enterprise were modified to add an additional management review prior to ordering, and to separate the responsibility for receiving shipments from the responsibility for maintaining the inventory records.

With regard to item (b) above, in FY 2005 the paper warehouse was moved to the Print shop floor from the warehouse that was adjacent to the dock. This was done to reduce the space occupied by Print thus reducing expenses. IPI was contacted and a security fence was ordered to secure the new space. The fence was installed in FY 2006. This is a locked area and only assigned staff have access.

Conclusion – Response accepted.

(2) Payroll – The Department processes and records payroll and personnel information on the Human Resource Information System (HRIS). The Human Resource Associates utilize an online P-1 document to initiate and approve payroll actions, such as adding new employees and recording pay raises. These individuals also have the ability to initiate and approve timesheets.

Recommendation – To strengthen controls, the Department should develop and implement procedures to segregate the duties of the Human Resource Associates from the duties of payroll.

Response –The Department will review its procedures to ensure they are providing adequate controls for payroll actions.

Conclusion – Response acknowledged. Procedures will be reviewed during the fiscal year 2006 audit.

(3) State Vehicle Dispatch – The Department maintains a vehicle pool for state employees to utilize or for other state agencies to purchase. At year end, the Department performs a reconciliation of vehicles per State Vehicle Dispatch records to its capital asset listing for financial reporting purposes. Unexplained variances in vehicle balances and discrepancies in vehicles reported were noted between State Vehicle Dispatch records and the Department's capital asset listing. In addition, identified variances had not been adjusted by the Department in a timely manner.

Recommendation – The Department should ensure the State Vehicle Dispatch records are reconciled to the Department's capital asset listing on a regular basis and adjustments, if any, are made timely.

Response – Fleet Management has implemented a capital asset protocol. The Purchasing Agent adjusts the capital asset inventory as vehicles are added or removed from the DAS Motor Pool.

Conclusion – Response accepted.

(4) Depreciation Ledger Reconciliation – The Department maintains a separate fund, Depreciation Revolving, which receives monthly depreciation payments from state agencies owning vehicles. A separate "depreciation ledger" is also maintained to track payments received and other activity/adjustments to the fund.

The Department reconciles I/3's cash balance in the Depreciation Revolving Fund to its depreciation ledger. However, the reconciliation for June 2005 was not performed until October 2005. Also, a variance of $1,350,946 was noted during this reconciliation. The Department could not explain the variance.

In addition, several items on the reconciliation were not properly supported and/or adjusted timely.

Recommendation – The Department should reconcile the I/3 cash balance in the Depreciation Revolving Fund to its depreciation ledger on a regular basis and reconciling items/adjustments should be made in a timely manner.

Response – The Department will review its procedures to ensure documentation is complete, procedures are clear and workloads are adjusted to accommodate the timeliness requirements of this reconciliation.

Conclusion – Response accepted.

(5) Deferred Compensation – The Department maintains two funds related to deferred compensation. Fund 711, Iowa Deferred Compensation Trust, accounts for the employee's payroll deductions and Fund 805, Deferred Compensation Match Trust, accounts for the employer's contributions.

The Department has not provided an explanation of the composition of the ending cash balances. The Department has indicated the cash balances include (spendable) interest earnings on the funds and may include deferred compensation deductions for which the employee has not identified the provider/company that should receive payment.

Recommendation – The Department should review the ending cash balances in Funds 711 and 805 for propriety and determine the composition of those balances. If funds are held due to lack of identification of a provider/company, the Department should contact the employee for the information needed to distribute the funds timely.

Response – State match funds are the only funds that are held pending the selection of an active provider. Employees have been contacted many times over the years about the need to select a match provider. Policy changes will require nearly all employees to pick a match company by July 1, 2006, so match contributions should be properly invested with an active provider shortly. Funds in 711 consist primarily of interest and administrative fees assessed to the community based correctional districts to add them to the program in 2001.

Conclusion – Response acknowledged. The composition of the ending balances in Funds 711 and 805 will be reviewed during the fiscal year 2006 audit.

(6) Capital Assets – Chapter 7A.30 of the Code of Iowa requires each department of the state to maintain a written, detailed and up-to-date inventory of property under its charge and control. The following were noted:

(a) The Department did not perform a reconciliation of capital asset additions to I/3 expenditures for capital assets. In several instances, General Fund purchased assets were recorded in various Internal Service Funds on the Department's capital asset listing. In one instance, an asset was recorded as both a General Fund and an Internal Service Fund asset. Also, depreciation expense was not recorded for one asset purchased by the General Fund but capitalized in an Internal Service Fund.

(b) The Department maintains an inventory of vehicles which can be purchased by state agencies. These vehicles are considered "unassigned vehicle inventory" and, therefore, no depreciation expense is recorded until the vehicles are purchased by a state agency and removed from inventory.

We identified thirty vehicles purchased by the Department from the unassigned vehicle inventory. The Department began depreciating these vehicles using the date the vehicles were purchased for the unassigned inventory instead of the date the Department purchased the vehicles from the unassigned inventory. As a result, depreciation expense and accumulated depreciation were overstated by $52,700.

(c) Capital assets totaling $3,111,156 purchased in fiscal year 2004 were not added to the Department's capital asset listing until fiscal year 2005.

(d) Depreciation expense and accumulated depreciation have not been recorded for $5,037,402 of land improvements.

(e) Sixty assets were selected from the Department's capital asset listing for observation. Of those sixty assets:

(1) Three were sent to surplus property, but there was no documentation to support the authorization and/or deletion of the assets.

(2) Three were sent to surplus property and appropriate documentation was maintained. However, the Department did not remove the assets from the capital asset listing.

(3) One asset could not be located.

(4) One asset was located at an employee's personal residence. Currently, the Department does not have a written policy on the removal/use of its equipment from state property.

Recommendation – The Department should develop procedures to ensure a detailed, up-to-date capital asset listing is maintained. Procedures should include, but not be limited to, ensuring capital asset additions are reconciled to I/3 asset purchases, vehicles are depreciated using the date purchased, depreciation expense is recorded for land improvements and asset deletions are properly authorized, supported and removed from the capital asset listing. Also, the Department should develop a written policy on the removal/use of equipment from state property and develop a log to track the location of this equipment.

Response – The Department will review its procedures to ensure documentation is complete and procedures are clear with regard to the recording of changes to capital assets.

Conclusion – Response acknowledged. A written policy on the removal/use of equipment from state property should also be developed.

(7) Accounting and Office Procedures Manuals – We encourage the development of standardized accounting and office procedures manuals to provide the following benefits:

(a) Aid in training additional or replacement personnel.

(b) Help achieve uniformity in accounting and in the application of policies and procedures.

(c) Save supervisory time by recording decisions so that they will not have to be made each time the same, or a similar, situation arises.

The Department has not completed written accounting and office procedures. For example, there was a lack of written procedures for:

- reconciliation of the State Vehicle Dispatch records to the Department's capital asset listing
- reconciliation of the I/3 cash balance in the Depreciation Revolving Fund to the Department's depreciation ledger

- reconciliation of the Department's capital asset additions to I/3 asset purchases
- reconciliation of the I/3 cash balance to the State Treasurer's general ledger
- reconciliation of the Risk System to I/3 for the calculation of the risk financing liability
- procurement card purchasing and payment processing.

Recommendation – The Department should develop written accounting and office procedures manuals.

Response – Procedure manuals will be finalized and provided to staff in order to guide them in these transactions. With regard to the comment relating to the written procedure for the "reconciliation of the I/3 cash balance to the State Treasurer's general ledger", currently, the cost/benefit analysis does not justify the time it would take to develop this manual. We will review again during FY 07.

Conclusion – Response accepted.

Findings Related to Statutory Requirements and Other Matters:

(1) Risk Financing – The State of Iowa is self-insured for various risks of loss related to its motor vehicle fleet. The Department maintains a database (Risk System) of various information relating to bodily injury and property damage for which the state may be liable. The following conditions were noted:

(a) The fiscal year 2005 vehicle damage amount reported on the Risk System is understated by $10,827 when compared to I/3 at June 30, 2005.

(b) In calculating the fiscal year 2005 risk financing liability, the Department utilized total claims paid from the Risk System and not total expenditures from I/3. This resulted in an understatement of the FY 05 liability of $11,894.

(c) No documentation was maintained for the IBNR rate utilized in the calculation of the risk financing liability.

(d) The annual reconciliation between the Risk System and I/3, for calculation of the risk financing liability, is not timely to detect missing claims or other necessary adjustments.

Recommendation – The Department should ensure reports are generated which support amounts reported for risk financing on the Department's GAAP Package and reconcile to I/3. In addition, the Department should ensure the annual reconciliation between the Risk System and I/3 is timely enough to detect missing claims or other necessary adjustments.

Response

(a) The identified variance is minimal and as long as agencies are allowed to perform in-house repairs, the Risk System and I/3 will never match. Additionally, agencies' in-house repairs are significantly less expensive than repairs by vendors. The variance between I/3 and the Risk System will continue to exist.

(b) The identified understatement is due to manual entry to the Risk System. In the future, the Risk System will use the total claims paid from I/3 when calculating the 2006 risk liability.

(c) The e-mail from the Insurance Division sent March 21, 2005, discusses the most current required IBNR. This e-mail has been retained in the Risk Manual. The IBNR will be obtained annually from the Insurance Division before the calculations are conducted.

(d) By mid-July, the annual reconciliation is completed. We feel this is timely since this occurs prior to closing the fiscal year books August 31st. Any identified problems can be corrected before the official closing of the books for the fiscal year.

Conclusion – Responses acknowledged. The Department needs to demonstrate the Risk System is reliable and can be reconciled to I/3. The reconciliation process should document variances and the underlying cause.

The e-mail provided during the FY 05 audit pertained to fiscal year 2004. IBNR documentation should be updated for the most recent audit period.

The reconciliations provided by the Department at year-end contained several unexplained variances. A quarterly reconciliation may identify items that could be corrected prior to year-end and/or provide an explanation for uncorrected variances.

(2) Billing Rates – Chapter 8A.121 of the Code of Iowa authorized the Department to establish customer councils for the purpose of overseeing utility services provided to governmental customers and to establish billing rates for those services.

The Department has three Enterprises which establish billing rates for utility services. They are General Services (GSE), Human Resources (HRE) and Information Technology (ITE).

During fiscal year 2005, HRE billing rates were selected for review. The following were noted:

- The Department did not document the methodology and/or assumptions used when establishing the billing rates.
- Underlying supporting documentation was not always maintained to substantiate the financial information compiled when establishing billing rates. For example, budgeted expenditures submitted to the Department of Management did not always agree with the budgeted expenditure information used in establishing the billing rates. The Department could not explain/support the variances. Also, support for full-time equivalent (FTE) information used in the calculation of certain rates was not maintained.
- The Department could not provide support for the expenditures allocated to HRE and used in the billing rate calculation for business administration, HRE leadership or shared services.

Recommendation – The Department should document the methodology and assumptions used when establishing billing rates for utility services and maintain appropriate supporting documentation.

Response – Efforts have already been made to improve documentation of utility rates for more recent fiscal years.

Conclusion – Response accepted.

(3) Leases – Beginning in fiscal year 2005, the Information Technology Enterprise (ITE) entered into numerous leases for computer equipment. ITE classified the leases as operating leases. However, based on the criteria established in Financial Accounting Standards Board (FASB) Statement Number 13 (FASB 13), certain lease agreements may be more appropriately classified as capital leases, not operating leases.

Recommendation – ITE should document the analysis of lease agreements and, using the criteria established by FASB 13, document the basis for classifying leases as operating versus capital.

Also, if the leases entered into during fiscal year 2005 meet the definition of a capital lease, Chapter 12.28 of the Code of Iowa states the Treasurer of State has sole authority to enter into financing agreements on behalf of state agencies. The Department should contact the Treasurer of State for resolution of this matter.

Response – DAS/ITE uses the HP lease contract negotiated and established by DAS/GSE; it is our understanding the contract requires leases to be FASB 13 compliant. We also use the lease option for equipment acquired from the IBM contract, which was also negotiated and established by DAS/GSE. Some equipment has been leased from Storagetek. Our use of these contracts do allow a "fair market value" purchase of the leased equipment at the end of lease; we have not, however, purchased any of the equipment that was previously leased nor have we entered into any lease arrangement having a "bargain purchase price" at end of lease.

The rationale used by DAS/ITE for utilizing operating leases (which we consider rent) can be summed up in following bullets:

1) Leasing/renting equipment drives a more level costing model resulting in a predictable base budget.

2) Leasing/renting forces us to regularly revisit the technical decisions we made and to determine if we are delivering the type and level of services our customers demand.

3) Leasing prevents us from becoming "locked" into a technology that isn't satisfactory or that doesn't meet our customer's current needs/requirements. Leasing allows us to periodically adjust our service offerings and service levels through replacement/upgrading equipment that is not best suited or the most appropriate to meet customer's service demands. When the equipment that is inadequate, unsatisfactory, or not needed it is removed – thus ending the need/responsibility for continued support and responsibility for it. Servers purchased by DAS/ITE 5 years ago, rather than leasing them, are currently in use and operational, they are not however, providing the needed level of service.

4) The Department of Transportation's life cycle analysis resulted in PCs and servers have a useful life of five (5) years.

DAS/ITE has previously entered into capital leases of equipment (lease-purchase or lease-to-own leases) using procedures and contracts provided by the Treasurer of State's office.

We believe that DAS/ITE's business model is effective and appropriate. The agency makes use of established state-wide/open-ended contracts established by GSE ensure FASB 13 compliance. If ITE were to consider purchasing equipment at the end of the lease (have not done so to date) it would be at the fair market value and not a bargain price.

Conclusion – Response acknowledged. In general, most lease agreements are "FASB 13 compliant" because they will either meet the criteria to be classified as an operating lease or the criteria for a capital lease. Based on our review of lease agreements with IBM, we noted certain agreements contain provisions which provide an option for a "bargain purchase price" (BPO) at the end of the lease term.

The Department should document the analysis of lease agreements and, using the criteria established by FASB 13, document the basis for classifying leases as operating versus capital.

(4) Service Contracting – Five service contracts were selected for compliance testing with Iowa Administrative Code Chapters 106 and 107. The following were noted:

- One contract was initially entered into in January 2004 for $10,000. The contract was amended in January 2005 to $52,000. There was no documentation to support whether bidding requirements were considered/met prior to the amendment.
- One contract was not signed prior to the start date.
- One vendor did not have a written contract in place.

Recommendation – The Department should ensure Iowa Administrative Code Chapters 106 and 107 requirements for service contracts are met and supporting documentation maintained to demonstrate compliance.

Response – The Department will review its procedures to ensure reasonable controls are in place to ensure compliance with IAC Chapters 106 and 107.

Conclusion – Response accepted.

(5) Centralized Purchasing Contracts – A review of fifteen centralized purchasing contracts identified the following:

- Two contracts, renewed with the current vendor, lacked documentation of the procedures performed by the Department during the renewal process. As a result, we were unable to determine whether the best price was obtained by renewing the contract or whether a separate bidding process could have achieved additional savings.
- Five contracts, in excess of $5,000 each, did not have documentation to demonstrate Targeted Small Businesses (TSB) were notified of the bid opportunity.
- Four contracts were not advertised for bids on the Department's website or newspapers.
- Two contracts were not signed by both parties.

Recommendation – The Department should develop written policies and procedures regarding the execution of the renewal option on purchasing contracts. Documentation should be maintained which demonstrates the best price and/or most favorable/beneficial results were achieved by renewing the contract instead of seeking bids from other vendors. In addition, the Department should ensure TSB's are notified of all applicable bid opportunities, contracts are advertised for bid on its website or newspaper and contracts are signed by all parties.

Response – Centralized Purchasing has provided the list of contracts to all purchasing agents and will comply with all of the provisions listed. Over the last two years, Centralized Purchasing has made a concerted effort to justify why a contract has been renewed. In some cases, the justification was not with the files and purchasing agents have been instructed to include information in the file.

In addition, Centralized Purchasing has redesigned the site where bid opportunities are posted. The new site will have archiving available and the Auditor's office will be able to look at the site to ensure that Code requirements are followed. This will eliminate printing copies of the bid posting and inserting a hardcopy in the file.

Conclusion – Response accepted.

(6) Compliance with the Code of Iowa – The Department was not in compliance with the following Chapters of the Code of Iowa during the year ended June 30, 2005:

(a) Chapter 8A.321(10) requires the Department Director to prepare an annual status report for all ongoing capital projects of all state agencies, as defined by section 8.3A, and submit the status report to the Legislative Capital Projects Committee. The Department did not submit a capital projects status report to the Legislative Capital Projects Committee for fiscal year 2005.

(b) Chapter 7A.3 requires the Department to submit a biennial report, covering the period ending June 30 in each even-numbered year, on the fiscal condition of the state. In addition, in each odd-numbered year, the Department is to file a summary report relating to its operations for the preceding fiscal year. The Department has not submitted the biennial report for the year ended June 30, 2004 or the summary report for the year ended June 30, 2005.

(c) Chapter 8D.10 requires the Department to submit an annual report before January 15th, certifying the identified savings associated with using the Iowa Communications Network.

(d) Chapter 8A.123(5)(b) requires the Department to submit by October 1st an annual report of the activities funded by and the expenditures made from an internal service fund established pursuant to Chapter 8A. The Department did not submit the report until October 20, 2005.

(e) Chapter 25.2(5) requires the Department, on or before November 1 of each year, to provide the Treasurer of State with a report of all unpaid warrants which have been outdated for two years or more. This report has not been made available in a format that can be used by the Treasurer's Unclaimed Property division.

(f) Chapter 8A.362(4)(c) requires the Department to submit an annual report by February 15th to the Iowa Department of Natural Resources regarding compliance with the corporate average fuel economy standards published by the United States Secretary of Transportation for new motor vehicles, other than motor vehicles purchased by the Iowa Department of Transportation, institutions under the control of the Board of Regents and the Iowa Department of the Blind. The Department did not submit the required report until June 15, 2005.

Recommendation – The Department should comply with the Code of Iowa or seek to repeal outdated code sections.

Response – With regard to item (a) above, the Department requested that the Legislature review this requirement during the 2006 Regular Legislative Session. Iowa Code Section 8A.321 (10) was amended to require the Department to provide an update for all ongoing capital projects of the Department of Administrative Services to the joint Transportation, Infrastructure and Capitals Appropriation Subcommittee. This amendment was included in 2006 Iowa Acts, House File 2782, Section 36. This language also conforms to the past practice of the Department. It should also be noted that similar reporting language is provided for other state departments who receive funding for capital projects (e.g. House File 2782, Sections 34 and 35).

With regard to item (b) above, the Department is attempting to determine what this report is and its necessity given a similar report completed annually by the Department related to the State's fiscal condition (see the Comprehensive Annual Financial Report also required of the Department). DAS has conferred with the Department of Revenue (which previously had responsibility for filing the section 7A.3 report), in an effort to determine what this report is. DAS will continue to discuss this report with the Department of Management and the General Assembly, as necessary, to clarify the purpose and need for this report.

With regard to item (c) above, this report was prepared and will be filed late. We will examine our process and implement changes to insure that this report is filed in a timely fashion as required. We will also examine our statutory reporting requirements to clarify or eliminate certain items, as appropriate, in an effort to permit us to manage these requirements more efficiently.

With regard to items (d) and (f) above, we are examining our process and will implement changes to insure that these reports are filed in a timely fashion as required. We will also examine our statutory reporting requirements to clarify or eliminate certain items, as appropriate, in an effort to permit us to manage these requirements more efficiently.

With regard to item (e) above, currently this is not available, but we possibly will be working on this in FY 07 as legislation was passed making funding available.

Conclusion – Response accepted.

Questions or requests for further assistance should be directed to:

Cynthia L. Weber, CPA, Manager
Deborah J. Moser, CPA, Senior Auditor II
Andrew E. Nielsen, CPA, Deputy Auditor of State

Other individuals who participated on the audits include:

Tammy A. Wolterman, Senior Auditor
Jeffrey L. Lenhart, Staff Auditor
Joseph M. Seuntjens, Assistant Auditor
Marta M. Sobieszkoda, Assistant Auditor
Jennifer L. Wall, Assistant Auditor
Janet M. Tiefenthaler, Assistant Auditor