



Appendix B
Report to the Technology Services Board

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

Report to the Technology Services Board

For the Fiscal Year Ended June 30, 2009

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

**Report to the Technology Services Board
For the Fiscal Year ended June 30, 2009**

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SAN MARCOS

SAN DIEGO

To the Technology Services Board
Department of Technology Services
Rancho Cordova, California

We have audited the financial statements of the State of California Department of Technology Services (Department), an internal service fund of the State of California, as of and for the fiscal year ended June 30, 2009, and have issued our report thereon dated January 25, 2010. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated May 7, 2009. Professional standards also require that we provide you with certain information related to our audit, which is included in the Required Communications section of this report.

In planning and performing our audit of the financial statements of the Department for the fiscal year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, we considered the Department's internal controls over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on internal control. Accordingly, we express no opinion on the effectiveness of the Department's internal control.

During our audit we became aware of a certain matter that represents an opportunity for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our current year recommendation and status of our prior year recommendations. (We previously reported on the Department's internal control in our report dated January 25, 2010). We did not audit the Department's responses to the findings identified in our report, and accordingly, express no opinion on it.

This letter does not affect our report dated January 25, 2010, on the financial statements of the Department.

We would like to thank the Department's management and staff for the courtesy and cooperation extended to us during the course of our engagement.

The accompanying report is intended solely for the information and use of the Technology Services Board and management of the Department and is not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 25, 2010

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

**Report to the Technology Services Board
Required Communications
For the Fiscal Year Ended June 30, 2009**

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Department are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2009. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were management's estimate of the depreciation and amortization of capital assets and intangible assets, accrued compensated absences, and other post-employment benefits (OPEB) costs and unfunded obligation.

Management's estimate of depreciation and amortization is based on the estimated useful lives of the related assets. Management's estimate of accrued compensated absences is based on the accrued vacation hours and hourly rate of each employee at year-end. Management's annual OPEB costs and unfunded obligation are based on the estimated costs of providing benefits to the Department's current and retired employees and spouses using actuarial methods and assumptions prescribed by GASB Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

**STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES**

**Report to the Technology Services Board
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2009**

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated January 25, 2010.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

**STATE OF CALIFORNIA
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**Report to the Technology Services Board
Current Year Finding and Recommendation
For the Fiscal Year Ended June 30, 2009**

I. ACCOUNTS RECEIVABLE RECONCILIATION

Our audit procedures disclosed unreconciled variances between customer accounts receivable balances and the general ledger as of the balance sheet date. We believe the main factors contributing to this deficiency were the implementation of the PeopleSoft accounts receivable module at the beginning of the fiscal year and the lack of a comprehensive reconciliation between the accounts receivable module and the general ledger at June 30, 2009. This lack of reconciliation led to the variances between actual accounts receivable balances and the amount recorded in the general ledger from being investigated. We recommend that procedures be established to ensure that customer accounts receivable balances are reconciled between the general ledger and the accounts receivable subsidiary system on a consistent and timely basis. Differences should be investigated and resolved as soon as possible. This procedure will also assist the Department in improving its internal control for the billing and collection of accounts receivable.

Management's response:

Management is in agreement. The Department will establish procedures to reconcile the general ledger to the accounts receivable subsidiary system in a timely manner. The Department will document and implement the new procedures prior to June 30, 2010.

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DEPARTMENT OF TECHNOLOGY SERVICES**

**Report to the Technology Services Board
Status of Prior Year Recommendations
For the Fiscal Year Ended June 30, 2009**

I. RECEIVING PROCEDURES AND SEGREGATION OF DUTIES - 2008

We noted that procedures for the receiving activities of the Department's primary receiving facility are not properly documented. We also noted that inadequate segregation of duties exist between receiving, recording and the distribution functions. We recommend a comprehensive procedure manual be prepared detailing procedures and responsibilities of the Department's receiving personnel that are adequately segregated.

Management's Response:

Management is in agreement. The Department will prepare a procedures manual detailing the responsibilities of the various warehouse staff, with a focus on the appropriate segregation of duties. The manual will be complete by June 30, 2009.

Status:

Implemented. The Department prepared written procedures detailing the responsibilities of the various warehouse staff including adequate segregation of duties.

II. VACATION HOURS - 2008

During our review of compensated absences, we noted that 111 employees accrued vacation hours in excess of the State's maximum allowed amount of 640. These employees accumulated a total of 20,716 hours in excess of the State's policy. We recommend that the Department monitor vacation balances and follow established policies to control future excessive accruals off vacation hours.

Management's Response:

The Department will monitor employee vacation hours and recommend supervisors encourage staff to use vacation hours in excess of 640 hours to the extent possible while maintaining business needs.

Status:

Not implemented. The department continues to monitor employee vacation hours and to recommend supervisors encourage staff to use vacation hours.

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

III. REGULAR INVENTORY OF CAPITAL ASSETS - 2006

During our review of capital assets, we noted that the Department maintains a separate subsidiary ledger, which has different assets listed than what is listed on the capital assets listing from the California State Business Unit. In addition, several assets recorded on the Business Unit's capital asset subsidiary ledger do not appear on the Department's subsidiary ledger. According to policy, before disposing of property, the Business Services Unit should be contacted to ensure proper approval and disposal of equipment. The Business Services Unit should prepare the Property Survey Reports (STD. 152), when the disposal of the property occurs, or Transfer of Location of Equipment (STD. 158), when the property is being transferred to another state department.

In the past two years, there has been no reconciliation between the Department's inventory of capital assets and the Business Unit's records. According to the Department's policy, an inventory count should be conducted annually. Because no physical inventory of the capital assets has been performed, it is uncertain whether or not certain assets still exist or are impaired. We recommend that the Department conduct regular physical inventories that would verify the existence and state of capital assets and update its capital asset subsidiary ledger as necessary. This subsidiary ledger should in turn be reconciled to the Department's general ledger and to the California State Business Unit in order to ensure accurate reporting of capital assets on the financial statements.

In addition, we recommend the capital assets inventory, be tagged with a number that is recorded in both the Department's and the Business Unit's subsidiary ledger. This process would improve management's ability to track the existence and possible impairment of capital assets.

Management's Response:

Management is in agreement. Effective with fiscal year 2006/07, the Department has consolidated all asset records to one system. Items purchased by the department are recorded into the Remedy system by the Business Service staff. The Business Service staff also tag each asset with an inventory number when items are received and before they are put into production. The Department has a policy in place for Business Service staff to prepare the Property Survey Reports when equipment is disposed or the Transfer of Location of Equipment form when property is transferred. The Department plans on conducting a statewide asset inventory by the end of the calendar year. At the time of the inventory the department will reconcile the asset records with the financial records.

Status:

Not Implemented. As a result of furloughs and reduction in staffing, the Department was unable to perform a statewide asset inventory. The Department has established a target date of June 30, 2011 to complete its statewide inventory.

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

IV. AGING OF “DUE FROM OTHER FUNDS” - 2006

During our examination of the receivable “due from other funds” account, we noted that \$28,881,000 of the total \$71,337,000 was outstanding for over 90 days as of June 30, 2006. In addition, another \$12,463,000 was outstanding for over 60 days as of June 30, 2006. The total aged receivables over the allowable 60-days as established by the Department represent \$41,344,000 or 58% of the total amount of the receivable. Although the aging of the receivables does not indicate an issue of collectibility (since the amounts are due from other State of California funds), it does significantly affect the Department management’s ability to properly manage cash flow, including timely payment of operating and nonoperating expenses. The Department relies entirely on its revenue collections to maintain a 60-day working capital reserve.

We recommend that Department management continue to communicate payment terms with the various customers that historically have not paid in accordance with such terms.

Management’s Response:

Management is in agreement. Collection of outstanding accounts receivables is critical to the operation of our department. The Department’s standard process for collection parallels the State guidelines. The Department sends out invoices and follows up with three collection letters at 30 day intervals. The Department also maintains contact with its customers to promote timely payment. Regardless of the Department’s efforts, over 50% of our customers are significantly late in making payments which is a major concern of the Department.

Status:

In Progress. During 2009, the Department actively pursued direct transfer authorization from the State Controller’s Office which enables the Department to collect fees charged to State Departments in a timely manner. The outstanding receivables should be greatly reduced as a result of these efforts.

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

V. REGULAR CHANGE IN PASSWORDS - 2006

Passwords used to access the Department's network and the PeopleSoft applications do not expire and there is no password configuration standard that is being enforced. This places the agency at an increased risk of unauthorized access to the network and financial data as well as all other electronic systems within the Department's network. We recommend that the Department formally adopt the Password Standards proposed by the Security Management Division as soon as possible and enforce an agency-wide password expiration period for network access and for financial application access.

Management's Response:

Management is in agreement. A password expiration period is currently not being enforced for either network or application access. The Department's network (Windows network) password expiration was deactivated during the Active Directory consolidation project. As of November 8, 2006, the Password Standards (Department of Technology Services Bulletin 3136), is being revised and will require that passwords for access to the network and servers expire after a period of 90 days. There is, however, no specific password standard governing access to the PeopleSoft application.

The Department's Security Management Division will work to develop and implement a Password Standard for the PeopleSoft application in the first quarter of calendar year 2007 and will work to ensure the password standard is enforced for both network and application access.

Status:

Implemented. PeopleTools was upgraded in March 2009. Since then, the PeopleSoft password configuration has been updated to comply with DTS Bulletin 3136 and includes complex password requirements, account lockout protocols, and password expirations. The Department has fully implemented the recommendation.

VI. DISASTER RECOVERY PLAN - 2006

The Department does not have a comprehensive business continuity and disaster recovery plan. A defined plan is needed to address how the Department would retrieve the Department's financial information and regain operations of the financial management system. A plan is also needed to define how the financial administrative units would operate in the event the financial management applications were unavailable for an extended period of time. Without a defined plan that has been thoroughly reviewed with all critical personnel and tested to ensure it is an operationally viable plan, the Department is at risk of losing the availability of financial data and the ability to conduct financial transactions in the event the financial management system were unavailable for an extended period. The Department Administrative Division, in conjunction with the Engineering and Operations Divisions, should work to

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

VI. DISASTER RECOVERY PLAN - 2006 (CONTINUED)

develop and implement a comprehensive business continuity and disaster recovery plan for the financial systems data and all financial applications. Once developed and implemented, the plan should be periodically tested to ensure its viability. All findings from the tests should be incorporated into updates to the plan.

Management's Response:

Management is in agreement. Although we do not have a plan for recovery of the Department's financial data in the event of a disaster, this is being addressed in the Continuity of Operations/Continuity of Government (COOP/COG) and an estimated completion date is scheduled for July 31, 2007. By this date management will have a comprehensive plan that covers the backup and recovery of all the Department's functions. The Governor's Office, OES and Agency are also aware of this date.

Status:

Implemented. The Department developed and implemented the Financial Services Business Recovery Plan as of November 2008. The plan was reviewed and approved by Department management in November 2008 and will be updated, reviewed, and approved annually.

VII. TERMINATION POLICY AND COMPUTER ACCESS - 2006

While procedures are in place to ensure that network access is rescinded for personnel who terminate employment with the Department (regular employees, temporaries, contractors, interns), there are no formal review procedures (internal audit procedures) to ensure only active personnel have access to the Department's network and servers. Additionally, there are no formal procedures to ensure that access to the PeopleSoft application is terminated for these same terminated personnel. Having terminated employees with access to the financial applications places the financial data at risk and increases the likelihood of inappropriate or malicious activity taking place.

The Department Security Management Division should develop formal procedures and perform an audit as soon as possible over all user identification logons used for accessing the Department's computer network and PeopleSoft application. This should be done to ensure that no terminated employees, temporaries, contractors, or interns remain active.

Management's Response:

Management is in agreement. The Department utilizes a custom application called Staff Movement that includes the exit clearance process. This application includes an automated notification to all areas of the department requesting access termination for departing employees. However, the application does not include automated deletion or disabling of application access. It is up to each of the areas to deactivate user codes. Security Management agrees that an audit has to take place and Security Management is in the process of establishing the guidelines for this audit. PeopleSoft application

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

VII. TERMINATION POLICY AND COMPUTER ACCESS - 2006 (CONTINUED)

managers have not historically been included in the notifications from the Staff Movement application. The Security Management Division will work to ensure that the PeopleSoft application managers are notified of departing personnel in a timely manner, so that their access may be rescinded. The audit guidelines and the procedures for notification of the PeopleSoft application managers will be completed in the first quarter of calendar year 2007.

Status:

In Progress. PeopleSoft security personnel continue to be notified by the DTS Staff Movement application when an employee is terminated. PeopleSoft analysts indicate that they periodically compare a list of active user accounts to the network accounts. The Department will coordinate with the Security Management Division to deploy a formalized policy to be completed by April 2010.

VIII. POLICY FOR PERIODIC REVIEWS - 2006

While authorization profiles have been established within the PeopleSoft application there is no policy requiring the periodic review of users and their authorizations to ensure they are up-to-date and enforce a proper segregation of duties. The Department Security Management Division should develop and implement a policy requiring the periodic review of user authorization roles within the financial applications to ensure they are up-to-date and enforce a proper segregation of duties.

Management's Response:

Management is in agreement. The Security Management Division is in the process of establishing a policy that will address this finding. The policy is scheduled for completion by March 2007.

Status:

In Progress. Currently, personnel that assign Peoplesoft access and authorization rights are notified by management of any changes of duties and responsibilities of staff. Documentation of testing of the authorization roles to ensure a proper segregation of duties is not being maintained. We continue to recommend that the Department develop and implement a policy requiring the periodic review of user authorization roles within the financial applications to ensure they are up-to-date and enforce a proper segregation of duties. In addition, documentation of these periodic reviews should be maintained as an audit trail. The Department will coordinate with the Security Management Division to deploy a formalized policy to be completed by April 2010.

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DEPARTMENT OF TECHNOLOGY SERVICES**

**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

IX. PASSWORD PROTECTION – CONFIGURATION POLICY - 2006

The Department's current password policy does not require that passwords be used for both network or application access, nor does it define a minimum password configuration standard for application access. The lack of appropriate password management places the agency at an increased risk of unauthorized access to the system and the financial data. While this lack of a complete password configuration policy is being addressed with the development of formal Password Standards, it has yet to be issued to all the Department's functional users. The Department should make a concerted effort to adopt and issue the Password Standards policy as soon as possible. Upon issuing the policy, audits should be performed by the Security Management Division to ensure compliance.

Management's Response:

Management is in agreement. As addressed in Section V. REGULAR CHANGE IN PASSWORDS, the Password Standards (Department of Technology Services Bulletin 3136) has been revised as of November 8, 2006 and defines a password configuration standard for network and server access. A password standard, however, has not been implemented for application (PeopleSoft) access. The Department's Security Management Division will work to implement an application password standard and will establish procedures to ensure audits are performed to ensure compliance. These efforts will be completed in the first quarter of calendar year 2007.

Status:

Implemented. As addressed in Section V. REGULAR CHANGE IN PASSWORDS, the Department has implemented Bulletin 3136 for its PeopleSoft Financial system with the upgrade of PeopleTools in March 2009.

X. ACTIVITY METRICS - 2006

IT activities are not periodically evaluated against defined metrics and reported to senior management. It is through a defined set of activity metrics, such as network and application up-time, transactional processing time, and helpdesk response time, that the performance of the IT organization can be measured and tracked. Without defining the expectations of the IT organization, it is difficult to ascertain performance from year-to-year. The Department's Operations and Engineering Divisions, in conjunction with the functional user departments should identify and establish a defined set of IT activity metrics upon which the divisions are rated. These metrics should be periodically reported to senior management.

Management's Response:

Management is in agreement. The agency understands the importance of the activity metrics in measuring and tracking the performance of the service deliverables and has plans to begin working on metrics and procedures by June 2007.

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**Report to the Technology Services Board
Status of Prior Year Recommendations (Continued)
For the Fiscal Year Ended June 30, 2009**

X. ACTIVITY METRICS - 2006 (CONTINUED)

Status:

Implemented. As of first quarter 2008, the Office of Technology Services tracks performance measures for six major core programs: application hosting, administration, equipment hosting, security, shared services, and telecom network.

STATE OF CALIFORNIA
DEPARTMENT OF TECHNOLOGY SERVICES
Schedule of Uncorrected Misstatements
For the Fiscal Year Ended June 30, 2009

Impact of Adjustments on Financial Statements - Increase (Decrease)
Amounts Expressed in Thousands

Description (Nature) of Audit Difference	Statement of Net Assets			Changes of Net Assets		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
Accrue phone and data line expense. (2009)	\$ -	\$ 425	(425)	\$ (425)	\$ -	\$ (425)
Decrease software maintenance expenses related to the accrual of costs for 2010 activity. (2009)	-	(981)	981	981	-	981
Increase receivable balance to correct posting error during implementation of accounts receivable module. (2009)	1,598	-	1,598	1,598	-	1,598
<i>Subtotal</i>	\$ 1,598	\$ (556)	\$ 2,154	\$ 2,154	\$ -	\$ 2,154
Financial statement amounts	\$ 145,936	\$ 87,308	\$ 58,628			\$ (15,339)
Impact as a percentage of financial statement amounts	1.10%	-0.64%	3.67%			-14.04%