SOUTH CAROLINA
STATE ETHICS COMMISSION

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 1998

CONTENTS

INDEPENDENT ACCOUNTANT’S REPORT ON APPLYING AGREED-UPON PROCEDURES

July 12, 1999

The Honorable James H. Hodges, Governor
and
Members of the Commission
South Carolina State Ethics Commission
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the South Carolina State Ethics Commission, solely to assist you in evaluating the performance of the South Carolina State Ethics Commission for the fiscal year ended June 30, 1998, in the areas addressed. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures and the associated findings are as follows:

1. We tested selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the tested receipt transactions were adequate. We also tested selected recorded receipts to determine if these receipts were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement. We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law. We compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year and, using estimations and other procedures, tested the reasonableness of collected and recorded amounts by revenue account. We also tested the accountability and security over permits, licenses, and other documents issued for money. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Earmarked Subfund Accounting and Object Codes in the Accountant’s Comments section of this report.

2. We tested selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the Commission, and were paid in conformity with State laws and regulations and if internal controls over the tested disbursement transactions were adequate. We also tested selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to various STARS reports to determine if recorded expenditures were in agreement. We compared current year expenditures to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Earmarked Subfund Accounting and Object Codes in the Accountant's Comments section of this report.

3. We tested selected recorded payroll disbursements to determine if the tested payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the tested payroll transactions were adequate. We tested selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS. We also tested payroll transactions for selected new employees and those who terminated employment to determine if internal controls over these transactions were adequate. We compared amounts recorded in the general ledger and subsidiary ledgers to various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement. We performed other procedures such as comparing current year payroll expenditures to those of the prior year; comparing the percentage change in total personal service expenditures to the percentage change in total employer contributions; computing the percentage distribution of fringe benefit expenditures by fund source and comparing the computed distribution to the actual distribution of recorded payroll expenditures by fund source; and estimating the fringe benefit expenditures and comparing them to actual fringe benefit expenditures to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Earmarked Subfund Accounting and Payroll in the Accountant's Comments section of this report.

4. We tested all recorded journal entries and interagency appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate. Our finding as a result of these procedures is presented in Earmarked Subfund Accounting in the Accountant's Comments section of this report.

5. We tested selected entries and monthly totals in the subsidiary records of the Commission to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and the internal controls over the tested transactions were adequate. The transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

6. We obtained all monthly reconciliations prepared by the Commission for the year ended June 30, 1998, and tested the fiscal year-end reconciliations of balances in the Commission's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. For the final reconciliation, we recalculated the amounts, agreed the applicable amounts to the Commission's general ledger, agreed the applicable amounts to the STARS reports, determined if reconciling differences were adequately explained and properly resolved, and determined if necessary adjusting entries were made in the Commission's accounting records and/or in STARS. We judgmentally determined to select the fiscal year-end reconciliations for testing. Our finding as a result of these procedures is presented in Reconciliations in the Accountant's Comments section of this report.

7. We tested the Commission's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 1998. We found no exceptions as a result of the procedures.

8. We obtained copies of all closing packages as of and for the year ended June 30, 1998, prepared by the Commission and submitted to the State Comptroller General. We reviewed them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our finding as a result of these procedures is presented in Closing Packages in the Accountant's Comments section of this report.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified areas, accounts, or items. Further, we were not engaged to express an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express such opinions. Had we performed additional procedures or had we conducted an audit or review of the Commission's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor and of the governing body and management of the South Carolina State Ethics Commission and is not intended to be and should not be used by anyone other than these specified parties.

Thomas L. Wagner, Jr., CPA
State Auditor

<u>ACCOUNTANT'S COMMENTS</u>

SECTION A - MATERIAL WEAKNESSES AND/OR VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

The procedures agreed to by the agency require that we plan and perform the engagement to obtain reasonable assurance about whether noncompliance with the requirements of State Laws, Rules, or Regulations occurred and whether internal accounting controls over certain transactions were adequate. Management of the entity is responsible for establishing and maintaining internal controls. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Therefore, the presence of a material weakness or violation will preclude management from asserting that the entity has effective internal controls.

The conditions described in this section have been identified as material weaknesses or violations of State Laws, Rules, or Regulations.

EARMARKED SUBFUND ACCOUNTING

The Commission records lobbyist registration fee revenue; Capital Reserve Fund Appropriations revenue; and, in the fiscal year 1998, an insurance claim proceeds for computer equipment damage in its earmarked subfunds. The Agency records State General Fund appropriation transactions in the general subfund. We reviewed the Commission's accounting records and noted several problems in how the Commission handles its earmarked funds transactions.

We compared prior year to current year expenditures and noted large or unusual variances in expenditures by subfund between fiscal years. Many of the Commission's expenditures seemed to be arbitrarily charged between the general and earmarked subfunds from fiscal year to fiscal year.

The 1997-1998 Appropriation Act Part IB, Proviso 17F.1. states that any agency "whose operations are covered by funds from other than General Fund Appropriations shall pay from such other sources a proportionate share of the employer costs of … and any other employer contribution provided by the State for the agency's employees." The Commission maintained inadequate documentation to demonstrate how it calculated the allocations of fringe benefits and that it properly charged a proportionate share of fringe benefits to each subfund. Also, it improperly charged payroll costs to the general fund because it did not have budget remaining in the earmarked subfund to pay an employee in accordance with the fund source authorized on her employee profile form. The Commission recorded these transactions in its general ledger with journal entries. These journal entries did not include evidence of independent review and approval by someone other than the preparer before being recorded in the accounting records.

The Commission also collects significant amounts for sales of the printed Ethics Manual and copies of lobbyists registration lists, principals registration lists, etc. These collections are recorded in error as reimbursements of expenditures to object code 0303, copying equipment supplies, in the general subfund. Consequently, for several years, at fiscal year-end, the Commission has reported a negative expenditure balance for this object code.

Section 8-13-360 of the 1976 South Carolina Code of Laws, as amended, states that the Commission "shall provide copying facilities at a cost not to exceed the actual cost" and mail the requested information "upon payment of appropriate postage, copying costs, and employee labor costs." Generally accepted accounting principles (GAAP) for governmental funds explain that "Reimbursements are necessary when an expenditure attributable to one fund initially was made from another fund." Whereas, revenue is recognized when an exchange has taken place and collection of the sales price is reasonably assured.

We recommend the Commission account for these printing and copying sales receipts as earmarked subfund sales revenues and match appropriate printing, copying, salary, fringe benefit, and other costs against these revenues by recording them as expenditures in the same subfund as the revenues. We also recommend that the Commission determine the costs of providing these items to the public in order to establish the fees to charge. It should determine which expenditures should be paid from this revenue source and try to be consistent each fiscal year. When establishing employee labor costs, the Commission should estimate sales and other revenues for the fiscal year to ensure that it establishes the proper earmarked personal services and employer contributions budgets and the proper percentages by payroll funding sources (general and earmarked funds) on the employee profile forms. We recommend that the Agency monitor its budgets by subfund and object code on an ongoing basis. When actual revenues and expenditures by funding source differ significantly from estimates, the Commission's budget and employee profile information should be timely updated during the fiscal year.

Regarding the payroll and fringe benefit weaknesses, we recommend that the Commission ensure that the proper amounts of personal services expenditures and proportionate amounts of employer contributions are recorded in the correct subfunds. We recommend that the Commission determine the amount of earmarked subfund salary and fringe costs improperly charged to the general fund for fiscal year 1998 and process a prior year expenditure refund remitting the monies to the State General Fund in accordance with Section 11-9-125 of the 1976 South Carolina Code of Laws, as amended. The Commission should develop and implement procedures to ensure that each journal entry and other accounting documents include proper supporting documentation of the reason for the transaction and the calculation of the amounts. In addition, journal entries should be properly reviewed by someone independent from the preparer before recording them in the accounting records.

PAYROLL

Besides the payroll findings described in the Earmarked Subfund Accounting comment regarding recording expenditures in the proper subfund and documenting the allocation of fringe benefit expenditures by subfund, we also noted that, for one of its two new hires in fiscal year 1998, the Commission did not pay the employee in the proper pay period and did not pay her the proper amount. The employee began work on January 15 and worked six hours that first day. The Commission should have paid her for a full day for January 16 (last day of pay period) and for the six hours worked on January 15 on the February 1 pay date. Instead, it paid her for the six hours on the February 16 pay date and did not pay her for working on January 16.

The Commission has little employee turnover; therefore, it processes few payments for partial payroll periods. The Commission made administrative errors and misunderstood advice it sought to determine how to process a “one pay period” form.

Proviso 72.19. of the 1997-98 Appropriation Act continued the established regular schedule for payment of employees beginning with the first fiscal year 1998 pay period of June 2 through June 16 of the prior fiscal year to be paid on July 1. It states that "this schedule, thus established, will continue from one fiscal year to another without interruption, on a twice monthly basis."

We recommend that the Commission comply with the established State pay period schedule and develop procedures to ensure that all pay calculations are correct, paying close attention to payroll changes as a result of hiring and terminating employees, and changing salary rates. The accountant calculating payroll changes should document her work and attach it and other documentation (e.g., evidence of pay rate; dates of hire and termination of employment; hours worked on the first and final dates of employment; annual leave balance on the date of termination) to the payroll voucher. The executive director as part of the process of reviewing and approving the payroll voucher should verify and recalculate and approve any changes. Also, we recommend the Commission pay the employee for the one day she was underpaid at her then-authorized rate.

SECTION B - OTHER WEAKNESSES NOT CONSIDERED MATERIAL

The conditions described in this section have been identified as weaknesses subject to correction or improvement but they are not considered material weaknesses or violations of State Laws, Rules, or Regulations.

RECONCILIATIONS

Section 2.1.7.20 of the Comptroller General's Policies and Procedures Manual (STARS Manual) requires agencies to perform reconciliations of revenues, expenditures, and ending cash balances at least monthly on a timely basis to ensure adequate error detection and correction and to satisfy audit requirements. Such reconciliations also provide assurance that transactions are processed correctly both in the Commission's accounting records and in the Statewide Accounting and Reporting System (STARS).

STARS reports expenditures by subfund. At June 30, 1998, the Commission had three unexplained expenditure reconciling items ($240.06, $4,143.75, and $701.79) in both the general and earmarked subfunds between its accounting records and STARS. The Commission charged these expenditures to the incorrect subfund on its books. Agency personnel did not detect the errors because the Commission reconciles to STARS by total expenditures instead of expenditures by subfund. Monthly expenditure reconciliations by subfund would have detected these errors.

In addition, we noted that the Commission does not maintain or reconcile cash accounts. Consequently, we were unable to reconcile balances in the Commission's books to the STARS Cash Status Report. Monthly reconciliations of the Commission's cash balances would have detected the effects of the expenditure coding errors described in paragraph two.

We recommend that the Commission establish cash accounts in its accounting system. We recommend that the Commission implement procedures to ensure that it performs all required reconciliations of revenues, expenditures, and ending cash balances in the frequency and manner prescribed by the STARS Manual. Its revenue and expenditure reconciliations should be at the subfund and object code level of detail.

CLOSING PACKAGES

The State Comptroller General's Office obtains certain generally accepted accounting (GAAP) information from agency-prepared closing packages to prepare the State's financial statements. Section 1.8 of the GAAP Closing Procedures Manual (GAAP Manual) states that each agency is responsible for submitting accurate and complete closing package forms that are completed in accordance with instructions and emphasizes that "The accuracy of closing package data is extremely important." For the fiscal year ended June 30, 1998, the Commission was required to prepare four closing packages. We noted errors on two of the four.

Fixed Assets

Section 3.8 of the GAAP Manual requires that each agency with general fixed assets submit a general fixed assets summary form to the Comptroller General's Office each fiscal year. On this form, the agency is to report by fixed asset category beginning balance, net corrections to prior year balances, additions, retirements, and the ending balance for the fiscal year. On the Commission's summary form for fiscal year 1998, the beginning balance did not agree to the fiscal year 1997 ending balance, net corrections to prior year did not agree with supporting documentation, and additions included items that were less than the Commission's capitalization criteria amount.

We also noted that the Commission's ending balance per its equipment listing differed from the ending balance per its summary form by an amount greater than that explained by the above variances. We were unable to determine the cause of the additional variance or whether the equipment listing or the summary form or neither was correct.

We recommend that the Commission review, correct, and update its equipment list and/or its fixed assets closing package at least annually to ensure that only items meeting its capitalization policy have been included. Each amount reported on its closing package should have supporting documentation and should be reconciled to the Agency's detail equipment listing.

<u>Operating Leases</u>

Section 3.19 of the GAAP Manual requires each agency to report future fiscal years' minimum lease payments for noncancelable operating leases with initial or remaining terms at June 30 exceeding one year. The Commission incorrectly calculated the minimum lease payments for fiscal year ending June 30, 1998.

Beginning for fiscal year 1998 closing packages, Section 3.19 states that operating lease executory costs included as part of the minimum lease payment should not be included when calculating the minimum lease payment. Such executory costs should be stated separately in Section V of the operating leases summary form. The Commission included the executory costs in the minimum lease payment amount in Section II of the summary form. Consequently, it overstated the minimum lease payment amount by $25,870 and understated executory costs by the same amount.

We recommend that the Commission implement procedures to ensure that proper amounts are used when reporting operating lease amounts. We also recommend that the Commission carefully read all GAAP Manual instructions and properly complete all requirements. It should be alert for new or changed requirements of the Comptroller General which are highlighted in the Summary of Revisions section which is distributed with the annual updates of the GAAP Manual.

OBJECT CODES

In our tests of disbursements and fiscal year-end cut-off of expenditures, we determined the Commission miscoded two of the 25 and two of the 27 disbursements selected for testing. The Commission miscoded one in the cut-off test to the improper major object while the remaining exceptions were miscoded at the minor object level.

We also noted in our receipts test that the Commission miscoded five of the 25 receipts selected for testing as reimbursements of expenditures. If these receipts were really reimbursements of expenditures, the Commission should have recorded portions of the receipts for the Ethics Manual book to expenditures object code 0209 - printing, binding, and advertising; however, it recorded the entire amounts as reductions to object code 0303 – copying equipment supplies. (See our Earmarked Subfund Accounting comment regarding the Commission's failure to properly record those fees as sales revenue.)

Sections 2.1.2.1 and 2.1.2.40 of the STARS Manual state that the State Comptroller General determined that four levels of object classification are required to fully classify receipt and expenditure data. The object code refers to the commodity or service obtained from an expenditure or to the source of revenue.

We recommend that the Commission implement procedures to ensure that revenues and expenditures are coded correctly to the four levels of detail and reimbursements of expenditures (when GAAP definitions dictate that transaction classification) are recorded as credits to the four-level expenditure object codes where the initial disbursements were recorded.

MANAGEMENT'S RESPONSE