

**SOUTH CAROLINA
OFFICE OF THE ADJUTANT GENERAL
COLUMBIA, SOUTH CAROLINA**

STATE AUDITOR'S REPORT

JUNE 30, 2008

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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

April 14, 2009

Major General Stanhope S. Spears
Adjutant General
State of South Carolina
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the management of the South Carolina Office of the Adjutant General (the Office), solely to assist you in evaluating the performance of the Office for the fiscal year ended June 30, 2008, in the areas addressed. The Office's management is responsible for its financial records, internal controls and compliance with State laws and regulations. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified parties in this 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. **Cash Receipts and Revenues**

- We inspected selected recorded receipts to determine if these receipts were properly described and classified in the accounting records in accordance with the agency's policies and procedures and State regulations.
- We inspected 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 at the subfund and object code level from sources other than State General Fund appropriations to those of the prior year. We investigated changes in the general, earmarked and federal funds to ensure that revenue was classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$11,300 – general fund, \$78,600 – earmarked fund, and \$138,300 – federal fund) and ± 10 percent.

The individual transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Transaction Coding in the Accountant's Comments section of this report.

2. **Non-Payroll Disbursements and Expenditures**

- We inspected selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records in accordance with the agency's policies and procedures and State regulations, were bona fide disbursements of the Office, and were paid in conformity with State laws and regulations; if the acquired goods and/or services were procured in accordance with applicable laws and regulations.
- We inspected 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 those in various STARS reports to determine if recorded expenditures were in agreement.
- We compared current year expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$72,000 – general fund, \$84,300 – earmarked fund, and \$148,800 – federal fund) and ± 10 percent.

The individual transactions selected were chosen randomly. We found no exceptions as a result of the procedures.

3. **Payroll Disbursements and Expenditures**

- We inspected selected recorded payroll disbursements to determine if the selected 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 processed in accordance with the agency's policies and procedures and State regulations.
- We inspected 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 inspected payroll transactions for selected new employees and those who terminated employment to determine if the employees were added and/or removed from the payroll in accordance with the agency's policies and procedures, that the employee's first and/or last pay check was properly calculated and that the employee's leave payout was properly calculated in accordance with applicable State law.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement.
- We compared current year payroll expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$72,000 – general fund, \$84,300 – earmarked fund, and \$148,800 – federal fund) and ± 10 percent.

- We compared the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computed the percentage distribution of recorded fringe benefit expenditures by fund source and compared the computed distribution to the actual distribution of recorded payroll expenditures by fund source. We investigated changes of ± 5 percent to ensure that payroll expenditures were classified properly in the agency's accounting records.

The individual transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Payroll in the Accountant's Comments section of this report.

4. **Journal Entries, Operating Transfers and Appropriation Transfers**

- We inspected selected recorded journal entries, and all operating and appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, the purpose of the transactions was documented and explained, the transactions were properly approved, and were mathematically correct; and the transactions were processed in accordance with the agency's policies and procedures and State regulations.

The journal entries selected were chosen randomly. We found no exceptions as a result of the procedures.

5. **General Ledger and Subsidiary Ledgers**

- We inspected selected entries and monthly totals in the subsidiary records of the Office to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; and selected entries were processed in accordance with the agency's policies and procedures and State regulations.

The transactions selected were chosen randomly. We found no exceptions as a result of the procedures.

6. **Reconciliations**

- We obtained all monthly reconciliations prepared by the Office for the year ended June 30, 2008, and inspected selected reconciliations of balances in the Office's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if accounts reconciled. For the selected reconciliations, we determined if they were timely performed and properly documented in accordance with State regulations, recalculated the amounts, agreed the applicable amounts to the Office'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 Office's accounting records and/or in STARS.

The reconciliations selected were chosen randomly. Our finding as a result of these procedures is presented in Reconciliations in the Accountant's Comments section of this report.

7. **Appropriation Act**

- We inspected agency documents, observed processes, and/or made inquiries of agency personnel to determine the Office's compliance with Appropriation Act general and agency specific provisos.

We found no exceptions as a result of the procedures.

8. **Closing Packages**

- We obtained copies of all closing packages as of and for the year ended June 30, 2008, prepared by the Office and submitted to the State Comptroller General. We inspected them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements and if the amounts reported in the closing packages agreed with the supporting workpapers and accounting records.

Our findings as a result of these procedures are presented in GAAP Closing Packages in the Accountant's Comments section of this report.

9. **Status of Prior Findings**

- We inquired about the status of the findings reported in the Accountant's Comments section of the State Auditor's Report on the Office resulting from our engagement for the fiscal year ended June 30, 2007, to determine if the Agency had taken corrective action.

Our findings as a result of these procedures are presented in Transaction Coding, Payroll, and GAAP Closing Packages in the Accountant's Comments section of this report.

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, 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 management of the South Carolina Office of the Adjutant General and is not intended to be and should not be used by anyone other than these specified parties.



Richard H. Gilbert, Jr., CPA
Deputy State Auditor

ACCOUNTANT'S COMMENTS

SECTION A – VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

Management of each State agency is responsible for establishing and maintaining internal controls to ensure compliance with State Laws, Rules or Regulations. The procedures agreed to by the agency require that we plan and perform the engagement to determine whether any violations of State Laws, Rules or Regulations occurred.

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

TRANSACTION CODING

During our analytical review of revenues, we determined that the Office used revenue object code 7403 (Rent – State-Owned Property) to transfer cash from subfund 3174 to subfund 3043 to fund capital projects. The Office should have used revenue object code 7221 (Miscellaneous Transfer – Other Funds). Also, during our review of the capital assets closing package, we noted that the Office reported equipment costing less than \$5,000 under object code 0604 – Data Processing Equipment (Capitalizable). The equipment should be recorded under object code 5004 – Data Processing Equipment (Non-Capitalizable). The STARS Manual provides object code definitions to enable agencies to properly record transactions in accordance with generally accepted accounting principles (GAAP).

We recommend that the Office ensure that staff who process transactions are knowledgeable of appropriate STARS object code definitions.

PAYROLL

We determined that the Office incorrectly calculated the final pay for five of the twenty-five terminated employees tested. The Office staff calculated the terminated employees' partial pay based upon hours worked during the pay period instead of the percentage of time worked during the pay period. We also noted the Office staff incorrectly calculated the amount paid to two of the twenty-five newly hired employee pay transactions tested. One of the newly hired employees worked nine out of the ten workdays in the pay period, but was paid for ten workdays. The second newly hired employee worked 20 hours in the pay period but was paid for 21 hours. In total these errors resulted in a net overpayment of \$416.

Generally accepted accounting principles (GAAP) require that transactions be given consistent accounting treatment. Because the number of work days or hours available in each pay period varies, using an annual rate to calculate partial pay produces inconsistent results among pay periods. Accordingly, the Comptroller General's Office has recommended using a proportionate time approach for calculating partial pay. The South Carolina Code of Laws, section 41-10-50 states that, "when an employer separates an employee from the payroll for any reason, the employer shall pay all wages due to the employee within forty-eight hours of time of separation or the next regular payday which may not exceed thirty days." Additionally, section 8-11-30 states that, "it shall be unlawful for anyone to receive any salary from the state or any of its departments which is not due..."

We recommend the Office calculate partial pay using percentage of time worked. Further, we recommend that the Office establish control procedures to ensure that calculations are based on the correct number of hours or days as appropriate.

RECONCILIATIONS

The Comptroller General's Policies and Procedures Manual (STARS Manual) describes the importance of monthly reconciliations for the detection and correction of errors. Reconciliations between balances in the agency's accounting records and those in the State's accounting system (STARS) as reflected on the Comptroller General's reports provide significant assurances that transactions are processed correctly both in the agency's accounting system and in STARS and that balances presented in the State's Comprehensive Annual Report are proper. To ensure adequate error detection and to satisfy audit requirements, such reconciliations must be:

- Performed at least monthly on a timely basis (i.e. shortly after month end)
- Signed and dated by the preparer
- Reviewed and approved in writing by an appropriate agency official other than the preparer.

Our review of the fiscal year 2008 reconciliations disclosed the following deficiencies:

1. None of the monthly reconciliations were signed and/or dated by the reviewer. Consequently, we were unable to determine if the monthly reconciliations were reviewed in a timely manner.
2. Monthly reconciliations for all subfunds for fiscal months 01 through 04 as well as a number of individual subfunds for fiscal months 05, 06, 09, 10, and 13 were performed from two to three months after month-end.
3. The reconciliation performed for fiscal month 04, subfund 5178, did not provide an explanation for a reconciling item.
4. Reconciliations were not performed for fiscal months 10 through 13 for subfund 5544, 5604, and 5903.

We recommend the Office develop and implement procedures to ensure that all reconciliations are reviewed and approved in writing. The reconciliation should include the signature and date completed by the independent agency official in accordance with the STARS Manual. Additionally, we recommend that the Office perform monthly reconciliations on a timely basis and provide an explanation for each identified reconciling item.

GAAP CLOSING PACKAGES

Introduction

The Office of the Comptroller General (CG) obtains certain generally accepted accounting principles (GAAP) data for the State's financial statements from agency prepared closing packages. To accurately report the Office's and the State's assets, liabilities, and current year operations, the GAAP closing packages must be complete and accurate. Furthermore, Reference 1.7 of the Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) states that "The accuracy of closing package data is extremely important. Large errors jeopardize the accuracy of the State's financial statements. The existence of even "small" errors tends to cast doubt on the State internal control structure's ability to detect

and correct errors. All errors are avoidable. We all must work together to implement procedures that keep closing package errors to an absolute minimum. An adequate internal control system includes safeguards to ensure that your agency detects and corrects its own closing package errors. Whenever the Comptroller General's Office or auditors detect errors, it means that your agency's system of internal control could be stronger." Reference 1.7 further states that a supervisory employee should perform a review that includes tracing all amounts from the appropriate agency accounting records or other original sources to the working papers and finally to the closing package itself. The following describes the errors noted on certain fiscal year 2008 closing packages:

Operating Lease

We reviewed charges to object code 0401 (Rental – Office Equipment) and noted the Office omitted two lease agreements for mailing machines from the closing package. We determined that the Office understated future minimum lease payments by \$16,691 for one of the leases. We could not determine whether the second lease agreement was an obligation at June 30, 2008 because the Office could not provide us with a signed copy of the lease.

The GAAP Manual, Reference 3.19 states: "Agencies must report on this closing package all operating leases that are between a State agency and a non-State agency, are noncancelable, and at June 30 had a remaining term of greater than one year." This section further states "All working papers are subject to audit, even if your agency does not submit a closing package. Every agency should keep copies of each lease or rental agreement."

Operating Lease – Lessor

The GAAP Manual, Reference 3.20 states “For each current lease on property reported in Part A, determine if the lease is *noncancelable* (see Key Terms in Section 3.19) and whether it was in effect at the end of the fiscal year for which this Form is prepared. If so, determine the future minimum rental payments to be received and report these amounts in Part B.”

We reviewed the lease agreement documents for leases that the Office reported on its operating lease - lessor closing package. We determined that future minimum lease payments for two leases should not have been reported because the leases are cancelable. This error resulted in an overstatement of future minimum lease payments of \$296,250.

Cash and Investments

The Office was unable to provide us with documentation to support the authorized amounts for four petty cash accounts on the Cash and Investments Summary Form.

The GAAP Manual, Reference 3.1 states: “... the agency should keep any documents that support data on that Form. For example ... Correspondence authorizing petty cash accounts.”

Capital Assets

We tested the Office’s capital assets closing package and noted the following errors:

1. The Office reported capital asset retirements of \$11,663,299; however, this amount represented accumulated depreciation of the retired assets. The Office should have reported \$27,578,152 for the retired assets. This error resulted in an overstatement of \$15,914,853. The GAAP Manual, Reference 3.9 states “the State removes the book value and accumulated depreciation of a capital asset from its financial statements in the fiscal year of the retirement” and “a capital asset’s book value equals its historical cost.”

2. The Office was not able to provide adequate documentation to support the end-of-year capital asset balances and current year depreciation. Office staff told us that they conduct an annual physical inventory of assets costing \$1,000 or more even though the capital assets closing package only requires agencies to report assets costing \$5,000 or more. We asked the Office to provide us with a report of just the items costing \$5,000 or more. We determined that the report balances did not agree with the balances on the closing package. Additionally, there is no process in place to reconcile the physical inventory to the capital assets closing package. The GAAP Manual, Reference 3.9 states that an agency “should keep:

- Working papers to support each number on these forms.
- A detailed listing of all capital assets as of June 30.

The detailed listing should:

- Clearly distinguish capital assets from any other items on the listing, such as non-capitalizable assets tracked as part of your agency’s internal control procedures. The Comptroller General’s Office requires agencies to tag all movable assets between \$1,000 and \$5,000, and to maintain a listing of these assets for internal control purposes only. However, we recommend a separate listing for these non-capitalizable assets.”

3. Asset additions reported by the Office were \$8,955 more than the amount reported on the CSA416 report. The supporting workpapers included an explanation for this difference; however, the Office did not include an explanation of the difference on the closing package as required by the GAAP Manual instructions.

4. The Office excluded the sales tax associated with certain capital assets. The GAAP Manual, Reference 3.9 states “The historical cost of a purchased or constructed capital asset includes ... sales taxes.”

5. The Office reported non-capitalizable contract retentions of \$7,399; however, the retentions were associated with the State Emergency Operations Center which is a capitalizable project. The GAAP Manual, Reference 3.9 states “Building improvements are subsequent additions to, or renovations to, existing buildings that meet any one of the following three criteria:

- The improvement adds square footage to the existing building.
- The improvement is a major renovation that prepares an existing building for a new use.
- The improvement extends the useful life of the existing building.”

Recommendations

We recommend that the Office implement procedures to ensure that all closing packages contain accurate and complete information in accordance with the GAAP Manual requirements and instructions. The Office should design and implement procedures requiring an independent review of each closing package by an individual knowledgeable of closing package instructions to ensure the accuracy of the closing package and adequacy of documentation supporting the closing package. This independent review should be documented using the applicable reviewer’s checklist. The Office should reconcile its annual physical inventory of capital assets to its accounting records and closing package balances. Finally, we recommend that the Office retain all supporting documents and working papers with the closing package copies in accordance with GAAP Manual requirements.

SECTION B - STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountant's Comments section of the State Auditor's Report on the Office for the fiscal year ended June 30, 2007, and dated October 2, 2008. We determined that the Office has taken adequate corrective action on each of the findings except we have repeated Transaction Coding, Payroll, and GAAP Closing Packages in Section A of this report.

MANAGEMENT'S RESPONSE

CORRECTIVE ACTION PLAN,

Transaction Coding

1. Staff responsible for processing operating transfers now have more training and experience in processing operating transfers.
2. All transfers are reviewed for completeness and accuracy.

Payroll

Procedures for processing payroll have been changed to include the recommendation of using the percentage of time worked method for calculating partial pay.

Reconciliations

Reconciliations procedures have been reviewed with and personnel have reviewed the correct procedures.

Closing Packages

Operating Leases

Copies of Operating Leases are being obtained and kept on file and reviewed for policy and stipulations. One lease in question is being reviewed to verify whether it meets the criteria.

Operating Leases and Operating Leases - Lessor

1. A procedure package has been written and is maintained on all Closing Packages, including Operating Leases and Operating Leases- Lessors, containing all reports and documentation necessary to complete a closing package. The packages include the data required from the input documents and where they are to be entered into any spreadsheets. One lease in question is being reviewed for cancelability
2. All leases are reviewed to ensure that reporting criteria is met.
3. A copy of all leases is on file and included in the supporting documentation for the closing package.

Cash and Investments

1. A procedure package has been written and is maintained on all Closing Packages, including Cash and Investments, containing all reports and documentation necessary to complete a closing package. The package includes the data required from the input documents and where they are to be entered into any spreadsheets.
2. A request for change in authorization approved by the State Auditor's Office is on file for petty cash accounts.

Capital Assets

1. A procedure package has been written and is maintained on all Closing Packages, including Capital Assets, containing all reports and documentation necessary to complete a closing package. The package includes the data required from the input

- documents and where they are to be entered into any spreadsheets.
2. A member of Budget & Finance has been assigned the responsibility of State Property Officer reviewing all entries in SABAR including Land and Buildings and reviewing all assets on an annual or bi-annual basis. Additionally, depreciation balances and construction in progress will be reviewed to ensure proper balances are reported.
 3. The SABAR accounting software has not been maintained for Buildings and Land since 1999. SABAR is continuing to be addressed to be updated with the correct transactions to add any land and facilities that have not been added and delete any land and facilities that have been disposed prior to the SAP go live.
 4. Assets added to SABAR will include all pertinent data to identify and locate the asset.
 5. A reconciliation between asset additions and the Comptroller General's CSA416 report will be performed and maintained as part of the supporting documentation of the closing package.
 6. A property officer has been assigned and does a rolling inventory throughout the year.

As noted, a procedure package has been established for each closing package. This document includes all documentation that is necessary to complete a closing package and where the reports can be obtained or how they are to be run. Pertinent values used in these reports will be highlighted with an indication of where they are included in the report.

All backup documentation will be attached to each package with cross references to the data reported in the package.

This procedure will help eliminate errors, speed up the process, and allow for an easier independent review.

Point of Contact for All Findings:

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