

**SOUTH CAROLINA
OFFICE OF THE ADJUTANT GENERAL**

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 2001

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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

May 17, 2002

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 Agency), solely to assist you in evaluating the performance of the Agency for the fiscal year ended June 30, 2001, 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 to determine the reasonableness of collected and recorded amounts by revenue account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Deposits, Reconciliations, and Data Translation to the State in the Accountant's Comments section of this report.

Major General Stanhope S. Spears
Adjutant General
State of South Carolina
May 17, 2002

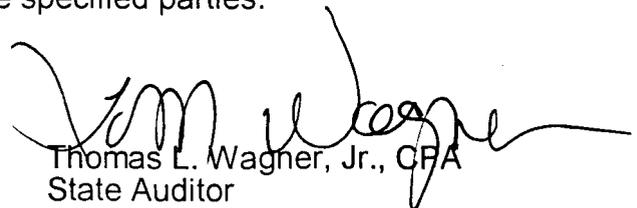
2. We tested selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the Agency, and were paid in conformity with State laws and regulations and if internal controls over the tested 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 those in various STARS reports to determine if recorded expenditures were in agreement. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Reconciliations, Permanent Improvement Project Accounting, and Data Translation to the State 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. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Reconciliations and Payroll and Personnel in the Accountant's Comments section of this report.
4. We tested 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, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate. The individual transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.
5. We tested selected entries and monthly totals in the subsidiary records of the Agency 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. Our findings as a result of these procedures are presented in Reconciliations in the Accountant's Comments section of this report.
6. We requested all monthly reconciliations prepared by the Agency for the year ended June 30, 2001, in order to test selected reconciliations of balances in the Agency's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. Our findings as a result of these procedures are presented in Reconciliations and Data Translation to the State in the Accountant's Comments section of this report.

Major General Stanhope S. Spears
Adjutant General
State of South Carolina
May 17, 2002

7. We tested the Agency'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 2001. Our findings as a result of these procedures are presented in Deposits, Reconciliations, Closing Packages, Payroll and Personnel, Schedule of Federal Financial Assistance, Public Assistance, and Permanent Improvement Project Accounting in the Accountant's Comments section of this report.
8. We reviewed the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the Agency resulting from our engagement for the fiscal year ended June 30, 2000 to determine if adequate corrective action has been taken. Our findings as a result of these procedures are presented in various comments in Section A of the Accountant's Comments as described in Section B - Status of Prior Year Findings in the Accountant's Comments section of this report.
9. We obtained copies of all closing packages as of and for the year ended June 30, 2001, prepared by the Agency 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 findings as a result of these procedures are presented in Closing Packages in the Accountant's Comments section of this report.
10. We obtained a copy of the schedule of federal financial assistance for the year ended June 30, 2001, prepared by the Agency and submitted to the State Auditor. We reviewed it to determine if it was prepared in accordance with the State Auditor's letter of instructions; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our findings as a result of these procedures are presented in Reconciliations, Schedule of Federal Financial Assistance, and Data Translation to the State 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 Agency'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 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.


Thomas L. Wagner, Jr., CPA
State Auditor

ACCOUNTANT'S COMMENTS

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.

INTRODUCTORY COMMENTS

The entire operations under the South Carolina Adjutant General are very complex, including military operations at both the federal and state levels. Many employees under the Adjutant General's supervision are federal military and/or civilian employees and many of the federal military operations are funded and accounted for by federal agencies. The Adjutant General is also responsible for the South Carolina Office of the Adjutant General (the Agency), a State agency governed by the same State laws, rules, and regulations. The State Auditor's Office is responsible for any required audit functions for the Agency. These functions include an agreed-upon procedures engagement at the agency level as well as the inclusion of the State agency in the Statewide Single Audit and the audit of the State's financial statements.

For fiscal year 2001, the Agency had approximately \$9 million appropriations and 64 authorized full-time equivalent positions (FTEs) in general funds and approximately \$29.5 million appropriations and 180 FTEs in total funds. Most of the difference in general and total funds is federal funding for military operations, maintenance, and construction. In addition to the military operations, the Agency also has an emergency preparedness division.

In our comments that follow we refer to the entity as "the Agency". As such, we are referring to the State agency, South Carolina Office of the Adjutant General and not to all operations under the supervision of the Adjutant General. As necessary, we will mention these other operations and attempt to denote that these areas are not part of the entity to which these engagements apply.

DEPOSITS

We tested a sample of 50 deposits and noted that six deposits for \$2,622 contained some receipts that were not deposited timely in accordance with State law and Adjutant General regulations. A similar deficiency was noted in the State Auditor's Reports for the four prior fiscal years.

Proviso 72.1. of the fiscal year 2001 Appropriation Act requires that receipts be remitted to the State Treasurer at least once each week, when practical. Also, Adjutant General Regulation (AGR) 37-2, Paragraph 1-13.c.(4) requires all funds received to be deposited by Tuesday of each week.

We recommend that the Agency develop and implement control procedures to strengthen internal controls over cash receipts and revenues that will ensure that receipts are deposited and recorded in accordance with the Agency's policies and State law.

RECONCILIATIONS

As noted in State Auditor's reports for the four prior fiscal years, the Agency has not performed complete cash, revenues, expenditures, and CSA467 report (federal programs) reconciliations between its books and those of the State Comptroller General who maintains the State's books (STARS). During our current engagement, Agency personnel told us that they have established new procedures for preparing reconciliations and are continuing to work on reconciliations for these fiscal years and for fiscal year 2001 but do not expect to have them completed until the end of fiscal year 2003. Because these reconciliations were not performed, we were unable to agree year-end amounts between the Agency's books and STARS. We were also unable to perform analytical reviews for revenues, expenditures, and the distribution of fringe benefits since the information in the Agency's books, STARS, or both may be erroneous. Section 2.1.7.20 C. of the Comptroller General's Policies and Procedures

Manual (STARS Manual) requires these reconciliations to be performed at least monthly on a timely basis, be documented in writing in an easily understandable format with all supporting working papers maintained for audit purposes, be signed and dated by the preparer, and be reviewed and approved in writing by an appropriate agency official other than the preparer. Errors discovered through the reconciliation process must be promptly corrected in the agency's accounting records and/or in STARS as appropriate.

We recommend the Agency continue its process of completing reconciliations to ensure compliance with the STARS Manual requirements and to identify and correct errors in its accounting records and/or STARS as necessary.

FIXED ASSETS CLOSING PACKAGE

The State Comptroller General's Office obtains GAAP (generally accepted accounting principles) data from agency-prepared closing packages for 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 further states that, "The accuracy of closing package data is extremely important." Section 1.9 states, "Agencies should keep working papers to support each amount they enter on each closing package form." In addition, the GAAP Manual recommends an effective review of each closing package and the underlying working papers to minimize closing package errors and omissions. To assist each agency in performing effective reviews, the State Comptroller General's Office requires a reviewer checklist to be completed for each closing package submitted.

The Agency reported no outstanding construction commitments at June 30, 2001, on the fixed assets overview closing package. We determined that the Agency should have reported commitments of \$267,245 for remaining contract amounts related to two ongoing projects. A similar comment was included in the two prior State Auditor's reports.

Section 3.7 of the GAAP Manual requires agencies to compute outstanding construction commitments for each project in progress at June 30 as follows:

- The contract price
- Less: Amounts the State has paid contractors from the start of the project through June 30
- Less: Amounts Relating to the project that your agency has reported as accounts payable and/or retainage payable

Outstanding amounts for all projects in progress at June 30 should be added together and reported on the closing package.

We recommend that the Agency implement specific year-end procedures for reviewing construction contracts for outstanding commitments in order to report accurate information to the State Comptroller General's Office for inclusion in the State's financial statements.

PAYROLL AND PERSONNEL

Initial Pay

During our test of employee additions, we noted eight instances in which employees were not paid in a timely manner. Late payments ranged from several weeks to three months after starting work. The employees were not paid timely because required payroll documentation (e.g., employee leave and attendance records, and personnel/payroll action requests) was not submitted by the armory supervisors to the payroll department at headquarters in a timely manner. The Agency violated Section 4.2.22.1 of the Comptroller General's Policies and Procedures Manual (STARS Manual) which requires vouchers to be delivered to the Comptroller General within 30 days from the receipt of services. Also, one of the payments was made from fiscal year 2002 appropriations for services performed in fiscal year 2001 which violated Proviso 72.3 of the fiscal year 2002 Appropriation Act which states that "... the sums of money set forth ... are appropriated from the general fund of the state ...

and other applicable funds to meet the ordinary expenses of the state government for the Fiscal Year 2001–2002...” Similar comments were included in the State Auditor’s report for fiscal year 2000.

We again recommend that the Agency implement procedures to ensure that proper documentation for adding new employees to the payroll be promptly completed and submitted to the Agency’s payroll department.

Termination Pay

Two of the 25 termination pay transactions tested contained errors that resulted in a total overpayment of \$450.

One of the overpayments occurred because the Agency paid the employee for one day more than she actually worked during her final pay period. The other overpayment occurred because the Agency calculated an employee’s annual leave lump-sum payment based on a 40-hour workweek when the employee’s salary was based on a 37.5-hour workweek. Similar comments were included in the State Auditor’s report for fiscal year 2000.

An effective accounting system includes adequate documentation and control procedures (e.g., independent reviews of pay computations and independent verification of termination dates, annual leave balances, pay rates, etc.) to help ensure that errors will be detected and corrected in a timely manner and that payroll checks will be processed for the proper amounts. In addition, Section 8-11-30 of the 1976 South Carolina Code of Laws, as amended, states that it is unlawful for anyone employed by the State to pay salaries or monies to State employees that are not due.

We again recommend that the Agency implement procedures to ensure that final pay calculations are independently checked for mathematical accuracy and all information used in those computations is independently verified with source documents.

Personnel Addition

We tested a sample of 25 personnel additions and found that the Agency allowed one employee, an armory sitter, to begin work one week before his official hire date. Therefore, the Agency did not perform an appropriate background check nor receive completed W-2 forms from the individual prior to his beginning work.

An effective accounting system includes adequate control procedures over the hiring process to help ensure that all State and Federal requirements are met (e.g., complete application forms, background checks, complete W-2 forms).

We recommend that the Agency follow its procedures to ensure that persons are eligible and properly authorized and that all State and Federal employment requirements have been met prior to their beginning work.

SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE

The State Auditor's Office prepares the State's schedule of expenditures of federal awards (SEFA) from agency-prepared schedules of federal financial assistance (SFFA). The State Auditor's Office issues instructions to each agency for proper completion of the SFFA. The SEFA is the primary financial statement audited in the Statewide Single Audit. We tested the Agency's SFFA for fiscal year 2001 during our Statewide Single Audit and have summarized those findings below:

1. For one fund, the CFDA number reported on the SFFA was incorrect.
2. Total cash, revenues, and expenditures do not agree to the amounts reported on the Comptroller General's reports.
3. Expenditures of \$381,422 for two projects funded from the 1998 MCA grant funds were reported as 1999 MCA grant expenditures.
4. For two funds, the incorrect fund source codes were used.

Similar findings were noted in the State Auditor's Reports for the four prior fiscal years.

We again recommend the Agency establish policies and procedures to ensure that the schedule is accurate; complete; prepared and reviewed by trained personnel; and supported by its accounting system and grant files. We also recommend that the Agency reconcile its federal cash, revenues, and expenditures to the Comptroller General's Reports (see Reconciliations comment).

PUBLIC ASSISTANCE

Pass-Through Funds

The following comment was included in the State Auditor's Report for fiscal year 1999 and repeated for fiscal year 2000.

Section 3.3, page 9 of the GAAP Closing Procedures Manual states, "GAAP requires that the State use Agency Funds to account for any grant/entitlement funds that one agency will pass through to other State agencies ...Accordingly, **the Comptroller General's Office asks that agencies establish and use separate STARS subfunds for grants/entitlements they will pass through to other State agencies.**"

The Agency established two subfunds to account for federal grant pass-through funds received from the Federal Emergency Management Agency (FEMA). Subfund 5544 was established in fiscal year 1998 for hurricane relief and subfund 5903 was established several years ago for flood relief. The Agency recorded funds drawn from FEMA as credits to federal grant revenues and pass-through funds as debits to federal grant revenues. We noted several errors in the Agency's use of these subfunds. First of all, these subfunds translate to a governmental GAAP fund code in the State's GAAP-basis accounting system instead of to an agency GAAP fund code. Secondly, if the Agency had used these subfunds as it intended, federal grant revenues would have netted to zero for each subfund at fiscal year end because the Agency debited revenues instead of expenditures when recording the transfer to another State agency. This did not occur because of a subfund recording error. As we reported in the State Auditor's Report for fiscal years 1998 and 1997, the Agency recorded revenue received in the proper subfund; however, it transferred to another State agency approximately \$49,000 out of subfund 5544 instead of 5903, leaving subfund 5544 with a deficit revenue balance of approximately \$49,000. This error and approximately \$14,000 in ending cash balance created an ending balance of approximately \$63,000 in subfund 5903 federal grant revenues. In fiscal year 1999, subfund 5903 had no activity and therefore maintained its ending balance of approximately \$63,000. However, subfund 5544 reported revenue of approximately \$42,000 and a revenue transfer of approximately \$66,000 resulting in a deficit revenue balance of approximately \$73,000.

In our fiscal year 2000 State Auditor's Report, we commented that the Agency had no activity in these subfunds and therefore no change in the reported balances. Again, for fiscal year 2001, no activity or changes have occurred. The Agency anticipates correcting these subfunds when the reconciliation process is complete (see Reconciliation comment).

Reimbursed Funds

The following comment was included in the State Auditor's Report for fiscal years 1998 and 1997.

As noted above, the Agency receives FEMA funds as reimbursement for its expenditures (both direct and indirect expenditures). In July 1996, the Agency received \$339,412 from FEMA for administrative (indirect) costs related to Hurricane Hugo. The Agency should have remitted these funds to the State General Fund but instead it expended these funds in fiscal years 1998 and 1997 for its own use, mainly for equipment and automation.

Near the end of fiscal year 1997, the Agency incurred approximately \$852,000 in costs related to Hurricane Fran and received a supplemental appropriation to cover 100% of these costs. In July 1997 (fiscal year 1998), FEMA reimbursed the agency approximately \$657,000, which included 75% of the direct costs (FEMA's share) and approximately \$18,000 for administrative costs. As of December 1998 (eighteen months after it drew the funds), the Agency had not remitted any of these funds to the State General Fund and had spent approximately \$5,800 of these funds. The Agency stated that it believed it could keep the administrative funds and that it was unsure of the process to remit the other funds. The Agency does not equate administrative costs to indirect costs; therefore, it assumes that it can retain these funds.

As noted in the State Auditor's Report for fiscal year 1999, the Agency remitted \$651,494 of the \$657,000 in March 2000. However, as of the date of this report, the Agency still has not remitted remaining administrative costs of \$344,918 received from FEMA to the State General Fund.

Section 2-65-70 (A) of the 1976 South Carolina Code of Laws, as amended, states in part, "All indirect cost recoveries must be credited to the general fund of the State, with the exception of recoveries from research and student aid grants and contracts. " Code Section

11-9-125 states, "Federal and other funds must be expended before funds appropriated from the general fund of the State, to the extent possible, and any excess balances in accounts resulting from matching fund programs must be remitted to the general fund of the State. Federal or other funds generated by the expenditure of state funds, including refunds from prior year general fund expenditures, must be remitted to the general fund of the State if there is no federal or state requirement governing the specific use of the funds ..."

Recommendations

We again recommend that the Agency make correcting entries to its reported deficit balances and that the Agency implement procedures to ensure adherence to the State's accounting practices and GAAP regarding the establishment of subfunds in STARS and the GAAP funds to which they translate. Furthermore, the Agency should remit all indirect costs to the State General Fund, including the \$344,918 still owed at the date of this report. We further recommend that the Agency train its employees in the proper treatment of direct and indirect reimbursement of grant funds and that it ensure timely cash management of all such funds.

PERMANENT IMPROVEMENT PROJECT ACCOUNTING

In our 1998 Statewide Single Audit report, we noted several errors pertaining to federal funding of military operations. That audit addressed only federal non-compliance; however, we noted more significant non-compliance related to State accounting rules and regulations and Statewide Permanent Improvement Reporting System (SPIRS) requirements which we have reported in the State Auditor's Report for fiscal years 1998 and 1997 and repeated in the fiscal year 1999 and 2000 reports. An excerpt of that comment follows:

For armory construction projects funded with military construction funds, the State must provide a match of 25% of the total costs for armory construction projects that occur on State property. The Agency receives capital improvement bond (CIB) proceeds from the State for this match.

. . . the Agency expended \$107,487 as partial payment of a mediation settlement for the Pickens, Ware Shoals and Fountain Inn armories. It paid the \$107,487 entirely from the Pickens' CIB fund rather than prorating the expenditure between each of the three projects' federal (75%) and CIB (25%) funds. At December 31, 1998, the Agency had not corrected this error.

According to budget and finance (BF) as well as the facilities management officer (FMO), the Agency paid the voucher as such due to a lack of funds for each project. Our review of the permanent improvement program summary (a State Permanent Improvement Reporting Systems (SPIRS) report) at June 30, 1998, determined that the total budget balance for each of the three armories was sufficient to pay its share of the voucher. Upon further investigation, we determined the problem to be in the budget balance per source of funds (federal or CIB). We noted that CIB draws and related expenditures were materially equal for Ware Shoals and Pickens (including the \$107,487 erroneously charged entirely to Pickens). However for the Fountain Inn armory, the Agency had drawn the entire authorized CIB amount of \$763,800 but had only reported \$597,481 in related CIB-funded expenditures.

Based upon research and inquiries with BF and FMO, we determined that the Agency incurred expenditures in 1994 on the Pine Ridge Armory for which it did not have a sufficient budget. It originally charged these expenditures to Fountain Inn CIB fund and drew Fountain Inn CIB proceeds. Subsequently, both the expenditures and CIB draw were reclassified to the Pine Ridge CIB fund on the Agency's books but not on SPIRS. In so doing, the Agency intentionally drew and expended \$168,574 of CIB funds authorized for Fountain Inn on its Pine Ridge armory without State approval. FMO stated that the Agency believed additional State funds were going to be awarded for Pine Ridge and that the funds it "borrowed" from Fountain Inn for Pine Ridge could be repaid. These extra funds never materialized for Pine Ridge, and now Fountain Inn is short of funds and is "borrowing" from Pickens. In effect, the Agency has created a situation in which it continuously completes one project from a subsequent project's source of funds. We believe this practice might date back even further than 1994.

Section 2-47-35 of the 1976 South Carolina Code of Laws, as amended, specifies that no project authorized for any capital improvement bond funding can be implemented until funds are made available and describes an authorization and approval process for scope, budget, and funding changes. Part I, Chapter 4 of the State's Manual for Planning and Execution of State Permanent Improvements (SPIRS Manual) states that when an agency requests transferring funds between projects, it should ensure that sufficient funds remain in the project from which the funds are to be transferred. However, the procedures here relate to transferring balances of projects nearing or at completion instead of transfers from new projects to complete old projects. Both the Code and the STARS Manual specify responsibilities of the Budget and Control Board, Joint Bond Review Committee, and the General Assembly. However, the Agency did not inform oversight agencies or seek approval for its actions.

We were told the Agency still has not prorated the \$107,487 partial payment of a mediation settlement for Pickens, Ware Shoals, and Fountain Inn Hawk armories. These armory construction projects have since been completed. The matters related to the Hawk projects will not be resolved until the mitigation is settled, which is expected to occur in fiscal year 2002.

We again recommend that the Agency correct its and the State's books for projects over budget by funding source, for transactions made without proper authority and for use of improper accounts.

DATA TRANSLATION TO THE STATE

The following comment was included in the State Auditor's report for fiscal years 1998 and 1997 and repeated in the fiscal year 1999 and 2000 reports.

The State maintains two accounting systems: STARS which is its budgetary accounting system and Series Z which is its GAAP-basis accounting system. Agencies are required to submit all revenue and expenditure transactions to the State's Comptroller General to be processed in STARS and are required to reconcile their books to STARS. The Comptroller General translates STARS into Series Z and collects and processes other GAAP data on agency-prepared closing packages in order to produce its GAAP-basis financial statements. Both STARS and Series Z are table driven and for the financial statements to be accurate it is necessary that all the tables and translations be correct.

All federal grants and permanent improvement projects are assigned project numbers, which are four digit numbers. Recurring grants awarded by grant year maintain the same project number but retain their separate identity through the use of phase codes, which are two digit numbers that follow the project numbers. Together these six digit project/phase code numbers comprise the State's D38 table. When permanent improvement projects are funded by federal grants, the State uses a process to interrelate the grant and permanent improvement project/phase codes. This process is described in the STARS Manual in Section 2.1.2.50. For fiscal years 1998 and 1997, the Agency has not submitted accurate information in sufficient detail to the State to ensure that the project/phase codes are used properly. It has not interrelated its grants and permanent improvements as required by the State. Therefore, because the Comptroller General relied on this data, the State's financial statements are incorrect as they relate to the Agency. We could not determine the extent of the inaccuracies; however, we informed the auditors of the State's financial statements of the problem and also pointed out the significant size of the Agency.

The federal government assigns a catalog of federal domestic assistance (CFDA) number to most of its grants and cooperative agreements. The State requires each agency to provide the CFDA number for each grant when it obtains budgetary authority and approval for the grant. At this point, the State establishes the grant on the D38 table and also establishes a conversion table to relate D38 numbers and CFDA numbers. All documents submitted to the Comptroller General to be processed into STARS must include the project/phase code, if applicable.

Using the tables and the information provided on the transactions, the Comptroller General produces its CSA467 report which is a summary by project/phase code of cash, beginning fund balances, adjustment to beginning fund balances, revenues, and expenditures. The STARS Manual requires agencies to reconcile the CSA467 report to their books. See related findings in the comment, Reconciliations.

The State Treasurer is responsible for monitoring agencies' cash management and calculating interest receivable/payable under the federal Cash Management Improvement Act (CMIA). It uses data from STARS, including the project/phase codes and the translation to CFDA numbers to calculate cash balances by program. If these numbers and translations are inaccurate, then the interest calculations will also be inaccurate.

We noted that the Agency has significant errors in the translation of project/phase codes and CFDA numbers. Therefore, the State Treasurer's interest calculation is incorrect. Based on information provided by us, the State Treasurer requested the Agency to correct these errors in January 1999. On May 5, 1999, the Agency had not made the corrections.

Accounting personnel told us that steps have been taken toward correcting these issues by training its employees on the use of the Agency's accounting system (SABAR) and on the CG's STARS and Series Z requirements. While the training process is on-going the Agency anticipates correcting the errors by the end of fiscal year 2003 as it catches up on its monthly reconciliations (see Reconciliation comment). We recommend that the Agency continue in its efforts to train employees in the proper accounting of transactions and balances in its accounting system (SABAR), STARS, and GAAP-basis data provided to the Comptroller General. Also, we recommend that the Agency implement policies and procedures which ensure that all accounting data will be accurate, timely, and in compliance with all state and federal laws, rules, and regulations as well as with GAAP. The Agency should review the project/phase codes and CFDA numbers for each active grant and permanent improvement

project and should make all the corrections needed. It should contact the Comptroller General and State Treasurer to determine what action is needed to correct errors that have already occurred.

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 South Carolina Office of the Adjutant General for the fiscal year ended June 30, 2000, and dated June 5, 2001. We determined that the Agency has taken adequate corrective action on each of the findings, except as listed below which we have repeated in Section A of this report.

2000 Comment Title

2001 Comment Title

DEPOSITS

DEPOSITS

RECONCILIATIONS

RECONCILIATIONS

CLOSING PACKAGES

FIXED ASSETS CLOSING PACKAGE

Fixed Assets

PAYROLL

PAYROLL AND PERSONNEL

Initial Pay

Initial Pay

Termination Pay

Termination Pay

SCHEDULE OF FEDERAL FINANCIAL
ASSISTANCE

SCHEDULE OF FEDERAL FINANCIAL
ASSISTANCE

PUBLIC ASSISTANCE

PUBLIC ASSISTANCE

PERMANENT IMPROVEMENT
PROJECT ACCOUNTING

PERMANENT IMPROVEMENT
PROJECT ACCOUNTING

DATA TRANSLATION TO THE STATE

DATA TRANSLATION TO THE STATE

MANAGEMENT'S RESPONSE

Deposits

Although the Agency has improved its controls over revenues including the deposit process, it has not eliminated its problems with armory deposits. Military employees who turn over frequently do these deposits. Therefore, the Agency must continually train new people. The Agency has reissued guidance to the armories and other receipting locations regarding the required controls and procedures. Also, quality assurance and the armory operations coordinator offer one-on-one training and group training.

Reconciliations

The Agency has made significant improvement in the reconciliation process in fiscal year 2002. It has reconciled all current year revenues and expenditures by subfund. It still has not reconciled by project or reconciled old year balances. Because the Agency did not properly reconcile for several years and numerous differences exist between SABAR and STARS, it is experiencing a long, difficult process to correct the errors and bring the reconciliations up to date.

Fixed Assets Closing Package

The Agency made significant improvements in the closing packages prepared for fiscal year 2001. The Military Department of South Carolina has a complex fixed assets structure. Some assets are purchased and owned by the military, some are purchased and owned by the (State) Agency, and some are a combination. The Agency determined that many of the capital projects done via the (State) Agency will not be assets of the Agency. (Such is the case with capital projects built on 100% federal property at McEntire and McCrady.) Therefore, the Agency is seeking guidance from the Comptroller General as to the proper reporting for such projects and assets, especially in conjunction with the GASB 34 implementation. The Agency will continue to improve its closing package process.

Payroll and Personnel

Initial Pay. The Agency has been unable to solve its timing problems with armory sitters who intermittently work armory rentals at a rate of \$10 per hour. Either the sitter or the armory supervisor does not timely submit the paperwork to notify the payroll department that the sitter has worked or is authorized to work. Centrally, the Agency is unaware that a sitter has worked if the sitter does not submit a timesheet. However, the sitters are promptly paid when the paperwork is received.

In December 2001, the Agency developed a separate form for armory sitters, which combines the timesheet and the personnel action form. One of the purposes of this new form is to reduce the number of sitters who are not paid in accordance with all applicable rules.

Termination Pay. The Agency will determine why these errors occurred and implement procedures to prevent future occurrences.

Personnel Addition. As noted, this exception involved an armory sitter. Because the sitter is required to be in the National or State Guard, a background check is not

performed for this type of employee. However, a breakdown in control occurred when the paper work to put the sitter on the payroll lagged his start date. The Agency will reiterate the proper procedures to those involved.

Schedule of Federal Financial Assistance (SEFA)

The Agency is continuing to improve the controls over the SEFA. Since the Agency was able to reconcile current year revenues and expenditures in 2002, it expects to be able to produce a better SEFA for 2002.

Public Assistance

Pass-Through Funds. These old balances will be corrected when the reconciliations are brought up to date. As previously noted, the Agency has focused on current year reconciliations and has not been able to address reconciling differences from prior years.

Reimbursed Funds. The Agency expended the \$339,412 and \$5,506 of the \$657,000. The Agency did not realize that administrative costs should be remitted to the State General Fund. Currently, it does not have funds available to remit \$344,918. Having taken several budget cuts in fiscal years 2001 through 2003, the Agency does not anticipate having these funds in the near future. We will pursue this matter with State authorities to resolve this matter as soon as possible.

Permanent Improvement Project Accounting

The Agency and the contractor have reached an agreement with the Hawk projects (Pickens, Ware Shoals, and Fountain Inn) and the settlement will be complete in January, 2003. As a part of finalizing the settlement, the Agency will ensure that all three projects are properly charged and capitalized.

Data Translation to the State

The Agency has improved its understanding of how STARS and Series Z interrelate to each other and to SABAR. It is working to correct all such deficiencies in SABAR and in the information it provides to STARS and Series Z. It is working the State Treasurer to ensure that it properly complies with cash management requirements. Also, it is working with B&C Board – Budget Division, Grant Services to review the process and ensure the accuracy of its project/phase codes and CFDA number translation.

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