# SOUTH CAROLINA DEPARTMENT OF DISABILITIES AND SPECIAL NEEDS

## COLUMBIA, SOUTH CAROLINA

## FINANCIAL AND COMPLIANCE REPORT

## JUNE 30, 1998

# SOUTH CAROLINA
# DEPARTMENT OF DISABILITIES AND SPECIAL NEEDS

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## JUNE 30, 1998

INDEPENDENT AUDITORS' REPORT

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Department of Disabilities and Special Needs (the Department) as of and for the year ended June 30, 1998, as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as explained in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Government Accounting Standards Board Technical Bulletin 98-1, Disclosures about Year 2000 Issues, requires disclosure of certain matters regarding the year 2000 issue. The Department has included such disclosures in Note 25 to the financial statements. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the Department's disclosures with respect to the year 2000 issue made in Note 25. Further, we do not provide assurance that the Department is or will be year 2000 ready, that the Department's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department does business will be year 2000 ready.

The accompanying financial statements of the South Carolina Department of Disabilities and Special Needs are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State of South Carolina that is attributable to the transactions of the South Carolina Department of Disabilities and Special Needs, a department of the State of South Carolina, and do not include any other funds of the primary government of the State of South Carolina.

In our opinion, except for the effect of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the South Carolina Department of Disabilities and Special Needs as of June 30, 1998 and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

As described in Note 27 to the financial statements, the Department changed its method of accounting for cash and cash equivalents in the State's internal investment pool and investments as required by the provisions of Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Department taken as a whole. The supplemental information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Also, the accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated March 23, 1999 on our consideration of the Department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Columbia, South Carolina
March 23, 1999

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## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of all funds of the South Carolina Department of Disabilities and Special Needs were prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. A summary of significant accounting policies follows.

### a. Reporting Entity

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The primary government is the State of South Carolina. The State has determined that the Department is a part of the primary government, but is not legally separate.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity. The funds and account groups of the Department are included in the Comprehensive Annual Financial Report of the State of South Carolina.

The primary entity is financially accountable if it appoints a voting majority of the organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointment by the primary entity) <u>and</u> (1) it is able to impose its will on that organization <u>or</u> (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally independent if it holds all three of the following powers:

1. Determine its budget without another government's having the authority to approve and modify that budget.
2. Levy taxes or set rates or charges without approval by another government.
3. Issue bonded debt without approval by another government.

Otherwise, the organization is fiscally dependent on the primary entity that holds one or more of these powers.

The Department of Disabilities and Special Needs is an agency of the State of South Carolina established pursuant to Section 44-20-10 et seq. of the 1976 Code of Laws of the State of South Carolina, as Amended. The laws of the State and the policies and procedures specified by the State for State agencies are applicable to the activities of the Department. The mission of the Department of Disabilities and Special Needs is to improve services for citizens with mental retardation, autism, head and spinal cord injuries, and related disabilities. The Department advocates for people with mental retardation, autism, head and spinal cord injuries or related disabilities both as groups and as individuals to achieve access to appropriate services from all public agencies in South Carolina. When needed services cannot be achieved through such public agencies, the Department seeks resources to provide such services. The Department coordinates through local service coordination those services provided by other agencies with those provided directly by the Department and county disabilities and special needs boards.

The Commission of the Department of Disabilities and Special Needs, whose seven members are appointed by the Governor with the advice and consent of the Senate, is the governing body of the South Carolina Department of Disabilities and Special Needs. The Commission administers the programs of the Department by setting policy, which is implemented and carried out by the State Director and staff. The accompanying financial statements present the financial position and revenues, expenditures and changes in fund balances solely of the Department of Disabilities and Special Needs and do not include any other agencies, funds or account groups or units of the primary government of the State of South Carolina.

### b. Basis of Presentation - Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources available to the Department, the accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund types. Accordingly, all financial transactions have been recorded and reported by fund type. In accordance with governmental accounting standards, the portions of fund balances that are not available for appropriation and expenditure and/or are legally segregated for a specific use are presented as reserved at June 30, 1998. The portions of fund balances in which tentative uses have been established are presented as designated at June 30, 1998.

*Governmental Funds*

Governmental Funds finance most of the Department's governmental functions. The measurement focus of the Governmental funds is on sources, uses, and balances of financial resources. Governmental funds include the general, special revenue, capital projects and debt service funds.

The General Fund accounts for State appropriations which are approved by the General Assembly to fund operations of the Department, Medicaid reimbursements, other revenues designated for Departmental operations, and discretionary contributions, as well as expenditures for carrying out the related objectives. Additionally, revenues which arise from collection of Intermediate Care Facilities for the Mentally Retarded's patient day fee, rental property, sale of surplus supplies and equipment and other miscellaneous transactions which are remitted to the General Fund of the State as required by statute are accounted for in the general fund.

The Special Revenue Fund accounts for financial activity for grants received from various Federal agencies and work activity programs in which clients perform work for various companies which contract with the Department.

The Capital Projects Fund accounts for revenues earmarked for the purchase of, improvements to or repairs and maintenance to real property, including the initial equipment in new buildings. Expenditures for these assets are recorded in this fund and subsequently capitalized at cost in the general fixed assets account group if capitalization criteria are met. Resources recorded in this fund include proceeds from State Capital Improvement Bonds issued by the State and proceeds from Departmental Capital Improvement Bonds for which the Department is responsible for repayment when converted to intrastate notes payable. Proceeds from sale of real property as authorized by Proviso 32.2 of the 1998 Appropriations Act and transfers from other funds approved by the State Budget and Control Board are also recorded in this fund.

The Debt Service Fund accounts for charges to clients and third party insurers for room, board, and other services which are deposited with the State Treasurer and are legally restricted for the retirement of intrastate notes payable to the State. These notes represent the legal liability to repay draw downs from Departmental Capital Improvement Bonds. The draw downs are used to fund capital projects. With approval of the State Budget and Control Board, excess debt service funds may be used for specified capital project expenditures, awards to local disabilities and special needs boards, and non recurring prevention , assistive technology, and quality initiatives. Additionally, the General Assembly may authorize the use of debt service funds for purposes it deems appropriate. Principal and interest due on Departmental Capital Improvement Bonds are recorded as expenditures in the year due.

*Fiduciary Funds*

Fiduciary funds account for resources the Department holds as trustee or agent for individuals. Fiduciary funds include both trust and agency funds. Currently, the Department has only an agency fund.

The Agency Fund is custodial in nature and does not involve measurement of results of operations. Funds received by clients for their care and benefit are recorded in the Agency Fund. Each residential center serves in a fiduciary capacity with respect to receiving and disbursing these funds on behalf of the clients. The fund does not have any revenues or expenditures and therefore, does not have a fund balance. Transactions consist solely of receiving and disbursing funds belonging to clients. The Department is at all times liable to clients for the cash balances held as custodian.

*Account Groups*

Account groups are used to establish accounting control and accountability for a government's general fixed assets and the unmatured principal of its general long term debt. The General Fixed Assets Account Group accounts for all fixed assets of the Department. The General Long-term Debt Account Group accounts for all long-term obligations. Long-term obligations include bonds, notes, capital leases, and compensated absences.

**c. Basis of Accounting**

Governmental fund revenues and expenditures are recognized on the modified accrual basis of accounting. Revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures. Federal reimbursement type grants are recorded as revenues when the related expenditures are incurred. Proceeds from capital improvement bonds are recognized in the year authorized. Expenditures are recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term obligations, which is recognized when due. Payments for prepaid items are recognized as an expenditure in the year of payment. Transfers are recognized in the accounting period in which the interfund receivable and payable arise. Agency fund assets and liabilities are accounted for on the modified accrual basis.

**d. Budget Policy**

The Department is granted an annual appropriation for operating purposes by the General Assembly of the State of South Carolina. The appropriation as enacted becomes the legal operating budget for the Department. The Appropriations Act authorizes expenditures from funds appropriated from the General Fund of the State and authorizes expenditures of total funds. The Total Funds column in the Appropriations Act includes all budgeted resources. A revenue budget is not adopted for individual agencies. The General Assembly enacts the budget through passage of summary object of expenditure appropriations by program within agency within budgetary fund. Budgetary control is maintained at the summary object of expenditure level of the agency entity. Agencies may process disbursement vouchers in the State's budgetary accounting system only if enough cash and appropriation authorization exist. Agencies may request transfers of appropriations among summary object categories and/or among programs within the same budgetary fund.

Transfers of funds may be approved by the State Budget and Control Board under its authority or by the agency as set forth in Appropriations Act Proviso 72.9 as follows: Agencies are authorized to transfer appropriations within programs and within the agency with notification to the Division of Budget and Analyses and the State Comptroller General. No such transfer may exceed twenty percent of the program budget. Transfers from personal services accounts or from other operating accounts may be restricted to any level set by the Board.

Agencies may charge vendor, interagency, and interfund payments for fiscal year 1998 to fiscal year 1998 appropriations in July 1998. Up to 10% of original State General Fund appropriations to an agency may be carried forward and expended in the next fiscal year. Any unexpended State General Fund monies as of June 30th in excess of 10% of original appropriations automatically lapse to the General Fund of the State on July 31 unless authorization is received from the General Assembly to carry over the funds to the ensuing fiscal year. State law does not require the use of encumbrance accounting.

State law does not precisely define the budgetary basis of accounting. The current Appropriations Act states that the General Assembly intends to appropriate all monies to operate State government for the current fiscal year. The State's annual budget is prepared primarily on the modified accrual basis method of accounting with several exceptions, principally the cash basis for payroll expenditures. Because the legally prescribed budgetary basis differs materially from generally accepted accounting principles (GAAP), actual amounts in the accompanying budgetary comparison statement are presented on the budgetary basis. A reconciliation of the differences between the budgetary basis and generally accepted accounting principles basis is presented in Note 3.

The Statement of Expenditures - Budget and Actual - All Budgeted Funds presents actual expenditures on the budgetary basis of accounting compared to the legally adopted and modified budget on a summary object of expenditure basis. The level of legal control for each agency is reported in a publication of the State Comptroller General's Office titled <u>A Detailed Report of Appropriations and Expenditures.</u>

**e. Cash and Cash Equivalents**

The amounts shown in the financial statements as "cash and cash equivalents" represent petty cash, cash on hand with the State Treasurer, and cash invested in various instruments by the State Treasurer as part of the State's cash management pool and cash on deposit in banks.

Most State agencies, including the Department, participate in the State's internal cash management pool. Because the cash management pool operates as a demand deposit account, amounts invested in the pool are classified as cash and cash equivalents. The State Treasurer administers the cash management pool. The pool includes some long-term investments such as obligations of the United Stated and certain agencies of the United States, obligations of the State of South Carolina and certain of its political subdivisions, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. For credit risk information pertaining to the cash management pool, see the deposits disclosure in Note 4.

The State's internal cash management pool consists of a general deposit account and several special deposit accounts. The State records each fund's equity interest in the general deposit account; however, all earnings on that account are credited to the General Fund of the State. Investments in the pool are recorded at fair value. Interest earned by the Department's special deposit accounts is posted to the Department's account at the end of each month and is retained by the Department.. Interest/investment earnings are allocated based on the percentage of the Department's accumulated daily interest receivable to the income receivable of the pool. Investment income includes interest and dividend earnings, realized gains/losses, and unrealized gains/losses (arising from changes in the fair value of investments).

Some State Treasurer accounts are not included in the State's internal cash management pool because of restrictions on the use of the funds. For those accounts, cash equivalents include investments in short-term highly liquid securities having an initial maturity of three months or less.

### f. Inventories

Inventories of food, medical supplies and drugs, and maintenance materials and parts are accounted for using the "purchase" method whereby inventories are recorded as expenditures on acquisition and inventories on hand at year end are reflected at cost in the assets section of the balance sheet except for USDA commodities which are reflected at the fair market value on the date of acquisition using the first in, first out method. For financial statement purposes, inventories on hand as of each year end are offset by a fund balance reserve account except for USDA commodities which are offset by a deferred revenue account.

### g. Fixed Assets

Land, land improvements and infrastructure assets (streets, sidewalks, drainage systems and similar assets that are immobile and of value to the Department only), buildings, furniture, fixtures and equipment, and construction in progress capital outlays which are paid in full at time of acquisition are recorded as expenditures of the applicable fund and simultaneously capitalized at cost in the general fixed assets account group. Donated fixed assets are recorded at their fair market value on the date of contribution. Fixed asset additions purchased through installment purchase or capitalized lease contracts are capitalized in the general fixed assets account group in the year of acquisition at their total cost, excluding interest charges. Payments of principal on such contracts are recorded as expenditures of the applicable fund and program from which paid. Net interest expenditures are not capitalized. Cumulative capital project expenditures other than repair and maintenance projects are capitalized as land, land improvements, buildings, and equipment, furniture and fixtures in the general fixed assets account group when the projects are substantially complete and available for use. In accordance with generally accepted accounting principles for governmental entities, a provision for depreciation of general fixed assets is not recorded.

### h. Compensated Absences

State employees are entitled to accrue and carry forward at calendar year end a maximum of 180 days sick leave and 45 days annual vacation leave. Upon termination of State employment, employees are entitled to be paid for accumulated unused annual vacation leave up to the maximum of 45 days, but are not entitled to any payment for unused sick leave. At fiscal year end, state employees could have a maximum accumulated annual leave for which they could be paid of 60 days. The Department calculates the gross compensated absences liability for unused annual vacation leave based on recorded balances and reports the liability based on that portion the employer expects to compensate employees for the benefits through paid time off or cash payments. In the governmental funds, expenditures for compensated absences are recorded when payment is made. Therefore, the entire unpaid liability for the governmental funds, inventoried at fiscal year end current salary costs and the cost of salary related benefit payments, is recorded in the general long-term debt account group.

### i. Totals (Memorandum Only) Column

Amounts in the "Totals - Memorandum Only" column represent an aggregation of the combined balance sheet line items to facilitate financial analysis. Amounts in the "Totals - Memorandum Only" column are not comparable to a consolidation.

### j. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenditures and affect disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

### k. Other Significant Accounting Policies

Other significant accounting policies are included in the succeeding notes to the financial statements.

## NOTE 2. STATE APPROPRIATIONS

The Department is granted an annual appropriation for operating purposes as authorized by the General Assembly of the State of South Carolina. State appropriations are recognized as revenue when received and available. Amounts that are not expended by fiscal year-end are required to be returned to the General Fund of the State unless the Department receives authorization from the General Assembly to carry the funds over to the next year.

The 1997-98 original appropriation is the Department's base budget amount presented in the General Funds column of Section 32 of Part IA of the Appropriations Act. The following is a reconciliation of the original appropriation as enacted by the General Assembly to state appropriations revenue reported in the financial statements for the fiscal year ended June 30, 1998:

| | |
|---|---|
| Original Appropriation | $ 122,050,827 |
| Supplemental Appropriation from 1996-97 State General Fund Surplus for the Medicaid Match (Part III of 1997-98 Appropriations Act) | 1,174,000 |
| State Budget and Control Board Allocation: Employee Pay Increases (Proviso 17C.13) | 1,817,008 |
| Transfer from the Department of Health and Human Services for Home and Community Based Waiver Services | 634,616 |
| Transfer to the Department of Health and Environmental Control for Interagency Disabilities Prevention Program | (38,000) |
| Revised Appropriation - Legal Basis | $ 125,638,451 |
| Funding for Net Payroll Accrual Adjustments | (311,564) |
| State Appropriation Revenue - Accrual Basis | $ 125,326,887 |

Certain of the Department's payroll expenditures are funded from State General Fund appropriations. The "Due from the General Fund of the State" reported in the General Fund represents monies due from the State General Fund for applicable Departmental personal services and employer contributions expenditures accrued at June 30, but paid in July from 1998-99 appropriations. State law provides for such payroll costs to be paid from the next year's appropriations.

Proviso 72.44 of the 1997-98 Appropriations Act authorizes each agency to carry forward unspent State General Fund appropriations from the 1996-97 fiscal year into the 1997-98 fiscal year up to a maximum of 10% of its original appropriation less any appropriation reductions. Agencies which have separate carry forward authority must exclude the amount carried forward by such separate authority from their base for purposes of calculating the 10% carry forward. Pursuant to this proviso, the Department carried forward $354,056 to this fiscal year. The Department carried forward $848,582 of appropriations from 1997-98 to the 1998-99 fiscal year pursuant to Proviso 72.48 of the 1998-99 Appropriations Act.

The General Assembly by Joint Resolution in June 1997 (R223, H3402), appropriated $701,590 from the State's Capital Reserve Fund to the Department. The appropriations were for Genetic Research Equipment, $551,590, and Emerald Center Renovations, $150,000. These appropriations are included as Other Budgeted Funds in the Statement of Expenditures - Budget and Actual - All Budgeted Funds.

## NOTE 3. BUDGETARY REPORTING BASIS

The financial statements prepared on the legally enacted basis differ from the GAAP basis statements. Adjustments of the GAAP basis of accounting to the budgetary basis of accounting consist principally of reclassification from financial statement fund types to budgetary fund categories and reversals of payroll accruals and related fringe benefits. The Statement of Expenditures, Budget and Actual - All Budgeted Funds presents all funds for which a legal basis budget was enacted. Capital Projects and Debt Service Funds are not budgeted on an annual basis and are omitted from the statement. Acquisition of fixed assets by donation are unbudgeted while capital lease purchase transactions are budgeted in the year of payment. The following schedule reconciles the differences:

| | Financial Statement Fund Type | | Budgetary Fund Category | |
|---|---|---|---|---|
| | General | Special Revenue | General Fund | Other |
| Expenditures on GAAP Basis | $ 278,821,202 | 1,883,322 | | |
| Less: Unbudgeted Items | | | | |
| Donated Fixed Assets | (1,200) | | | |
| Fund Reclassifications: | | | | |
| State Appropriations | (124,829,275) | | $ 124,829,275 | |
| Federal Grants | | (1,669,974) | | $ 1,669,974 |
| Other | (153,990,727) | (213,348) | | 154,204,075 |
| Net Accruals: | | | | |
| Personal Services and Employer Contributions | | | 311,564 | (91,768) |
| Expenditures on Legal Basis | $ 0 | $ 0 | $ 125,140,839 | $ 155,782,281 |

## NOTE 4. DEPOSITS AND INVESTMENTS

All deposits and investments of the Department are under control of the State Treasurer who, by law, has sole authority for investing State funds.

*DEPOSITS:*

The following schedule reconciles deposits within the footnotes to the balance sheet amounts:

| | |
|---|---|
| Balance Sheet | |
| Cash and Cash Equivalents | $42,783,209 |
| Footnotes | |
| Cash on Hand | $ 9,900 |
| Deposits Held by State Treasurer | 42,671,993 |
| Other Deposits | 101,316 |
| | $42,783,209 |

Deposits Held by State Treasurer

State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within seven days. Information pertaining to the carrying amounts, fair value, and credit risk of the State Treasurer's deposits and investments is disclosed in the Comprehensive Annual Financial Report of the State of South Carolina. Deposits held by the State Treasurer include $286,138 in unrealized gains as of June 30, 1998.

Other Deposits

Funds not on deposit with the State Treasurer as of June 30, 1998 are Agency Funds with a carrying amount of $101,316 and a bank balance of $125,085. These funds are fully insured and collateralized with securities held by the Department's agent in the Department's name.

*INVESTMENTS:*

The accounts classified as "Investments" in the general fund are comprised of donated corporate stocks held by the State Treasurer in the Department's name and mutual funds, some of which are held by the State Treasurer and others of which are held by counterparty or agent not in the Department's name. Investments are carried at fair value.

The Department's investments other than mutual funds are categorized to give an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the entity or its agent in the Department's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the Department's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer or by its trust department or agent but not in the Department's name. The Department has investments in Category 1.

The fair value of the securities in Category 1 which are held by the State Treasurer in the Department's name at June 30, 1998 are $137,809 including unrealized gains of $109,195.

Also, the Department owns shares in mutual funds which are not subject to categorization, with a fair value of $234,027 including unrealized gains of $42,347.

## NOTE 5. RECEIVABLES

An analysis of receivables is as follows:

| | General Fund | Debt Service Fund |
|---|---|---|
| Total receivables | $ 11,607,352 | $ 894,241 |
| Less: Allowance for doubtful accounts | 0 | 112,892 |
| Net receivables | $ 11,607,352 | $ 781,349 |
| Amount available to meet current financial obligations | $ 11,607,352 | $ 318,954 |
| Amount not available to meet current financial obligations | | $ 462,395 |

In accordance with the Department's revenue recognition policy as outlined in Note 1, the receivables presented on the balance sheet are available to meet the current financial obligations. The above receivables not available to meet the current financial obligations are disclosed as amounts due the agency to meet future obligations. Allowances for doubtful accounts are based on historical analysis.

## NOTE 6. INVENTORIES

Inventories at June 30, 1998 consist of the following:

| | |
|---|---|
| Food | $ 181,890 |
| Medical and Drugs | 244,740 |
| Maintenance Materials and Parts | 124,562 |
| | $ 551,192 |
| Less, USDA commodities reflected in the Special Revenue Fund | (542) |
| Totals | $ 550,650 |

During fiscal year 1998 the Department received $9,893 of USDA commodities and consumed $12,384 of USDA commodities.

## NOTE 7. AMOUNTS DUE FROM/TO GENERAL FUND OF THE STATE

The amount due from the General Fund of the State at June 30, 1998 of approximately $4,100,000 represents the amount due for personal services and the related fringe benefits expenditures accrued at June 30th for employees funded by State Appropriations but paid on or after the subsequent July 1. South Carolina State law provides for the payroll accruals being paid with subsequent year appropriations.

The amount due to the General Fund of the State from the General Fund at June 30, 1998 of approximately $2,800,000 represents primarily Medicaid indirect and overhead cost recoveries and nursing home bed fees. The Medicaid indirect and overhead cost recoveries and nursing home bed fees were remitted in July 1997.

The amount due to the General Fund of the State from the Special Revenue Fund of approximately $700 at June 30, 1998 represents indirect cost recoveries billed to grantors but not yet received at June 30, 1998.

## NOTE 8. DUE BETWEEN FUNDS

Amounts due between funds represent short-term loans of approximately $116,000 from the general fund to the federal grants fund within the special revenue fund to fund temporary deficit cash balances. The short term loan of approximately $116,000 was liquidated in fiscal year 1998 when reimbursements were received from federal grantors.

The $12,500 advance between funds is a long term transaction to provide petty cash for client needs while the $1,000 advance between funds is a long term transaction to provide cash for the return check account as required by the State Treasurer.

## NOTE 9. CHANGES IN GENERAL FIXED ASSETS

A summary of changes in general fixed assets for the year ended June 30, 1998 follows:

| | Balances, July 1, 1997 | Additions | Deletions, Retirements | Balances June 30, 1998 |
|---|---|---|---|---|
| Land | $ 1,692,950 | $ | $ | $ 1,692,950 |
| Land Improvements | 3,530,132 | 245,496 | | 3,775,628 |
| Buildings | 81,130,965 | 1,283,285 | 2,196,950 | 80,217,300 |
| Equipment, Fixtures and Furniture | 21,413,129 | 1,381,651 | 1,434,744 | 21,360,036 |
| Construction in Progress | 1,482,846 | 1,316,780 | 1,565,102 | 1,234,524 |
| Total | $ 109,250,022 | $ 4,227,212 | $ 5,196,796 | $ 108,280,438 |

## NOTE 10. CONSTRUCTION COSTS AND COMMITMENTS

The Department has obtained the necessary funding for the acquisition, construction, renovation, and equipping of certain facilities. As of June 30, 1998 the Department had committed approximately $600,000 of these funds with certain property owners, engineering firms, construction contractors, and vendors. Management estimates that the Department has sufficient resources available to satisfactorily complete such capital projects which are expected to be completed in varying phases over the next two years at an estimated cost of approximately $7,000,000. Of the total cost, approximately $5,600,000 is unexpended at June 30, 1998. Also, the Department has projects which will be expensed over the next two years at an estimated cost of $6,300,000 with approximately $4,300,000 unexpended at June 30, 1998.

## NOTE 11. PENSION PLANS AND OTHER EMPLOYEE BENEFITS

Substantially all employees of the Department are covered by a retirement plan through the South Carolina Retirement System (SCRS), a cost-sharing multiple-employer defined benefit pension plan administered by the Retirement Division of the State Budget and Control Board, a public employee retirement system. Generally all state employees are required to participate in and contribute to the System as a condition of employment unless exempted by law as provided in Section 9-1-480 of the South Carolina Code of Laws. This plan provides annuity benefits as well as disability, cost of living adjustment, death and group-life insurance benefits to eligible employees and retirees.

The Retirement Division maintains four independent defined benefit plans and issues its own publicly available Comprehensive Annual Financial Report (CAFR) which includes financial statements and required supplementary information. A copy of the separately issued CAFR may be obtained by writing to the Retirement Division, 202 Arbor Lake Drive, Columbia, South Carolina, 29223. Furthermore, the Division and the four pension plans are included in the CAFR of the State of South Carolina.

Under SCRS employees are eligible for a full service retirement annuity upon reaching age 65 or completion of 30 years credited service. The benefit formula for full benefits effective July 1, 1989, for the System is 1.82% of an employee's average final compensation multiplied by the number of years of creditable service. An early retirement option with reduced benefits is available as early as age 55. Employees are vested for a deferred annuity after five years service and qualify for a survivor's benefit upon 15 years credited service. Disability annuity benefits are payable to employees totally and permanently disabled provided they have a minimum of 5 years of credited service. A group-life insurance benefit equal to an employee's annual rate of compensation is payable upon the death of an active employee with a minimum of one year of credited service.

Since July 1, 1988, employees participating in the SCRS have been required to contribute 6 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 9.466 percent which included a 1.916 percent surcharge to fund retiree health and dental insurance coverage. The Department's actual contributions to the SCRS for the years ending June 30, 1998, 1997, and 1996 were approximately $5,170,000 $5,510,000, and $5,680,000, respectively, and equaled the required contributions of 7.55 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $100,000 in the current fiscal year at the rate of .15 percent of compensation.

Some of the employees are covered by the South Carolina Police Officer's Retirement System (PORS), a cost-sharing multiple employer defined benefit public employee retirement plan. Generally all full-time employees whose principal duties are the preservation of public order, protection or prevention and control of property destruction by fire are required to participate in and contribute to the System as a condition of employment. This plan provides annuity benefits as well as disability and group-life insurance benefits to eligible employees and retirees. In addition, participating employers in the PORS contribute to the accidental death fund which provides annuity benefits to beneficiaries of police officers and firemen killed in the actual performance of their duties. These benefits are independent of any other retirement benefits available to the beneficiary.

Under PORS employees are eligible for a monthly pension payable at age 55 with a minimum of 5 years of service or 25 years of credited service regardless of age. In addition, employees who have five years of credited service prior to age 55, can retire yet defer receipt of benefits until they reach age 55. A member is vested for a deferred annuity with 5 years of service. The benefit formula for full benefits, effective July 1, 1989, for the system is 2.14% of the employee's average final salary multiplied by the number of years of credited service. Disability annuity benefits and the group-life insurance benefit for PORS members are similar to those for SCRS participants. Accidental death benefits provide a monthly pension of 50% of the member's budgeted compensation at the time of death.

Since July 1, 1988, employees participating in the PORS have been required to contribute 6.5 percent of all compensation. Effective July 1, 1997, the employer contribution rate became 12.216 percent which, as for the SCRS, included the 1.916 percent surcharge. The Department's actual contributions to the PORS for the years ending June 30, 1998, 1997, and 1996 were approximately $16,000, $17,000, and $20,000, respectively, and equaled the required contributions of 10.3 percent (excluding the surcharge) for each year. Also, the Department paid employer group-life insurance contributions of approximately $300 and accidental death insurance contributions of approximately $300 in the current fiscal year for PORS participants. The rate for each of these insurance benefits is .20% of compensation.

The amounts paid by the Department for pension, group-life, and accidental death benefits are reported as employer contributions expenditures of the applicable fund and program.

Article X, Section 16 of the South Carolina Constitution requires that all state operated retirement systems be funded on a sound actuarial basis. Title 9 of the South Carolina Code of Laws of 1976, as amended, prescribes requirements relating to membership, benefit and employee/employer contributions for each retirement system. Employee and employer contribution rates to SCRS and PORS are actuarially determined. The surcharges to fund retiree health and dental insurance are not part of the actuarially established rates. Annual benefits, payable monthly for life, are based on length of service and on average final compensation (an annualized average of the employee's highest twelve consecutive quarters of compensation).

The Systems do not make separate measurement of assets and pension benefit obligations for individual employers. Under Title 9 of the South Carolina Code of Laws, the Department's liability under the retirement plans is limited to the amount of contributions (stated as a percentage of covered payroll) established by the State Budget and Control Board. Therefore, the Department's liability under the pension plans is limited to the contribution requirements for the applicable year from amounts appropriated therefor in the South Carolina Appropriations Act and amounts from other applicable revenue sources. Accordingly, the Department recognizes no contingent liability for unfunded costs associated with participation in the plans.

At retirement, employees participating in the SCRS or PORS may receive additional service credit for up to 90 days for accumulated unused sick leave.

## NOTE 12. POST RETIREMENT AND OTHER EMPLOYEE BENEFITS

In accordance with the South Carolina Code of Laws and the Annual Appropriations Act, the State of South Carolina provides certain health care, dental, and life insurance benefits to certain active and retired State employees and certain surviving dependents of retirees. All permanent full-time employees and certain permanent part time employees of the Department are eligible to receive these benefits. The State provides post employment health and dental benefits to employees who retire from State service or who terminated with at least 20 years of State service who meet one or more of the eligibility requirements, such as age, length of service, and hire date. Generally those who retire must have at least 10 years of retirement service credit to qualify for State funded benefits. Benefits are effective at date of retirement when the employee is eligible for retirement benefits. These benefits are provided through annual appropriations by the General Assembly to the Department for its active employees and to the State Budget & Control Board for all participating State retirees, except the portion funded through the pension surcharge, and provided from other applicable revenue sources of the Department for its active employees who are not funded by State General Fund appropriations. The State finances health and dental plan benefits on a pay-as-you-go basis. Currently, approximately 19,000 State retirees meet these eligibility requirements.

The Department recorded employer contribution expenditures applicable to these benefits in the amount of approximately $6,870,000 for active employees for the year ended June 30, 1998. As discussed in Note 11, the Department paid approximately $1,310,000 applicable to the 1.916% surcharge included with the employer contributions for retirement benefits. These amounts were remitted to the South Carolina Retirement Systems for distribution to the Office of Insurance Services for retiree health and dental insurance benefits. Information regarding the cost of insurance benefits applicable to the Department retirees is not available. By State law, the Department has no liability for retirement benefits. Accordingly, the cost of providing these benefits for retirees is not included in the accompanying financial statements.

In addition, the State General Assembly periodically directs the Retirement Systems to pay supplemental (cost of living) increases to retirees. Such increases are primarily funded from System's earnings; however, a portion of the required amount is appropriated from the State General Fund annually for the SCRS and PORS benefits.

## NOTE 13. DEFERRED COMPENSATION PLANS

Several optional deferred compensation plans are available to state employees and employees of political subdivisions. Certain employees of the Department have elected to participate. The multiple-employer plans, created under Internal Revenue Code Sections 457, 401(k), and 403(b) are accounted for as agency funds of the State and included in the Comprehensive Annual Financial Report of the State of South Carolina. Employees may withdraw the current value of their contributions when they terminate State employment. Employees may also withdraw contributions prior to termination if they meet requirements specified by the applicable plan.

Compensation deferred under the Section 401(k) and 403(b) plans is placed in trust for the contributing employee. The State has no liability for losses under the plans. Under the Section 457 plan, all deferred compensation plan amounts and earnings remain assets of the employer (the State) subject to the claims of the employer's general creditors, one of whom is the employee participant. It is unlikely, however, that the State would ever use the plan assets to satisfy claims of the State's general creditors. The portion of assets of the Section 457 plan to which the State has access is disclosed in its financial report.

On August 20, 1996, the provisions of Internal Revenue Code Section 457 were amended by adding subsection (g). That subsection provides that new plans will not be considered eligible plans unless all assets and income of the plans are held in trust for the exclusive benefit of the participants and their beneficiaries. Existing plans also must comply with this requirement by January 1, 1999. South Carolina's plan adopted this change effective July 24, 1998.

## NOTE 14. OPERATING LEASES

The Department is obligated under certain operating leases for real property which expire in various years through 2028. The future obligations under these noncancellable leases with an initial or remaining term at June 30 of one year or more are as follows:

| | | |
|---|---|---|
| Year ending June 30, | 1999 | $ 1 |
| | 2000 | 1 |
| | 2001 | 1 |
| | 2002 | 1 |
| | 2003 | 1 |
| | Thereafter | 24 |
| | Total | $ 29 |

Lease payments for real property during the year ended June 30, 1998 were approximately $92,000.

The Department is obligated under operating leases for equipment which expire in various years through fiscal year 2003. The future obligations under these noncancellable leases with initial or remaining terms at June 30 of one year or more are as follows:

| | | |
|---|---|---|
| Year ending June 30, | 1999 | $ 158,415 |
| | 2000 | 153,137 |
| | 2001 | 62,481 |
| | 2002 | 13,972 |
| | 2003 | 1,767 |
| | Total | $ 389,772 |

Lease payments for equipment during the year ended June 30, 1998 were approximately $204,000.

## NOTE 15. CAPITAL IMPROVEMENT BONDS

In prior years the State authorized use of funds for capital projects using the proceeds of State Capital Improvement Bonds and Departmental Capital Improvement Bonds. The State Capital Improvement Bonds are issued as general obligations of the State and do not have to be repaid by the Department and, therefore, are not recorded as a Department liability. The Department is liable for repayment of the Departmental Capital Improvement Bonds (see Note 16 regarding intrastate notes payable.) The authorized funds can be requested as needed when approval to begin specific projects has been obtained from State authorities.

A summary of active Capital Improvement Bonds as of June 30, 1998 is as follows:

| | Amount Authorized at June 30,1998 | Authorized and Drawn in Prior Years | Drawn in Current Year | Undrawn at June 30, 1998 |
|---|---|---|---|---|
| State Capital Improvement Bonds | | | | |
| Act 194 of 1979 | $ 407,828 | $ 388,628 | $ | $ 19,200 |
| Act 518 of 1980 | 2,983,919 | 2,963,258 | | 20,661 |
| Act 538 of 1986 | 2,300,000 | 1,876,707 | 79,596 | 343,697 |
| Total | $ 5,691,747 | $ 5,228,593 | $ 79,596 | $ 383,558 |

| | | | | |
|---|---|---|---|---|
| Departmental Capital Improvement Bonds | | | | |
| Act 646 of 1978 | $ 1,938,290 | $ 1,646,867 | | $ 291,423 |
| Act 179 of 1981 | 1,392,093 | 1,386,942 | | 5,151 |
| Act 638 of 1988 | 2,100,000 | 38,763 | | 2,061,237 |
| Total | $ 5,430,383 | $ 3,072,572 | | $ 2,357,811 |
| Totals | $ 11,122,130 | $ 8,301,165 | $ 79,596 | $ 2,741,369 |

## NOTE 16. INTRASTATE NOTES PAYABLE

Intrastate notes payable to the State Budget and Control Board are for funds advanced for the financing of capital project expenditures from Departmental Capital Improvement Bonds (see Note 15). Future resources to repay these debts are to be provided from client fees. During the year ended June 30, 1998, the Department paid approximately $519,000 of principal and approximately $189,000 of interest on these notes.

A summary of the outstanding notes as of June 30, 1998 follows:

| Issue Date | Original Face Amount | Maturity Date | Interest Rate | Annual Principal Installment(A) | Unpaid Principal Balance June 30, 1998 |
|---|---|---|---|---|---|
| 09/29/79 | $2,100,000 | 12/01/98 | 5.250% | $105,000 | $ 105,000 |
| 10/20/80 | 2,300,000 | 12/01/99 | 9.000% | 115,000 | 230,000 |
| 06/08/87 | 735,669 | 12/01/06 | 6.400% | 37,000 | 333,000 |
| 06/01/93 | 2,288,348 | 06/01/09 | 6.650% | 116,093 | 1,797,458 |
| | | | | | $ 2,465,458 |

(A) For the year ended June 30, 1999.

Annual payments of principal are due on the notes with interest being payable semiannually.

Details of annual debt service, including interest, for each year are as follows:

| Year Ending June 30, | Intra-State Notes |
|---|---|
| 1999 | $ 529,135 |
| 2000 | 408,660 |
| 2001 | 286,117 |
| 2002 | 283,749 |
| 2003 | 281,381 |
| Thereafter | 1,557,476 |
| Total debt service obligations | $ 3,346,518 |
| Less, interest | 881,060 |
| Principal balances outstanding at June 30, 1998 | $ 2,465,458 |

## NOTE 17. CHANGES IN GENERAL LONG-TERM OBLIGATIONS

The following is a summary of changes in general long-term debt for the year ended June 30, 1998:

| | Balances July 1, 1997 | Additions | Retirements | Balances June 30, 1998 |
|---|---|---|---|---|
| Compensated Absences Payable(A) | $ 7,781,484 | $ 0 | $ 169,280 | $ 7,612,204 |
| Intrastate Notes Payable | $ 2,984,199 | $ 0 | $ 518,741 | $ 2,465,458 |
| Totals | $ 10,765,683 | $ 0 | $ 688,021 | $ 10,077,662 |

(A) Changes in compensated absences payable are reflected at net since details to support gross increases and decreases are not available.

## NOTE 18. MEDICAID COST REIMBURSEMENT

Medicaid revenues are received under cost reimbursement agreements from Medicaid intermediaries. For the year ended June 30, 1998, these reimbursements were approximately $165,000,000. Reimbursements are subject to examination and adjustments by the governmental intermediary. Adjustments to cost reimbursements are recorded in the period in which they are received. During the year ended June 30, 1998, the Department received Medicaid adjustments of approximately $3,400,000 for settlements resulting from examinations of the fiscal year ending June 30, 1996. Examinations of the fiscal year ended June 30, 1997 resulted in negative adjustments of approximately $500,000 during the year ended June 30, 1998 and notification of additional positive adjustments of approximately $3,900,000 to be received with future Medicaid reimbursements. The Medicaid desk audits for the year ended June 30, 1998 have not been completed as of the date of this report.

Proviso 32.4 of the 1998 Appropriations Act authorized the Department to retain and carry forward funds received due to prior year settlements under Medicaid funded contracts.

## NOTE 19. CONTINGENCIES

The Department is involved in a number of legal proceedings and claims with various parties arising in the normal course of business. These proceedings and claims cover a wide range of matters including personal injury, medical malpractice, and negligence. In some of these cases, the remedies that may be sought or damages claimed are substantial. Because, in the opinion of management and counsel, the risk of material loss in excess of insurance coverage for these events is remote, the outcome of the legal proceedings and claims is not expected to have a material adverse effect on the financial position of the Department. Therefore, an estimated liability has not been recorded. The outcome of any litigation has an element of uncertainty.

The various federal programs administered by the Department for fiscal year 1998 and prior years are subject to examination by the federal grantor agencies. At the present time, amounts which may be due federal grantors, if any, have not been determined but the Department believes that any such amounts in the aggregate would not have a material adverse effect on the financial position of the Department.

## NOTE 20. TRANSFER FROM DEBT SERVICE FUND TO GENERAL FUND

For the year ended June 30, 1998 the Department transferred $126,000 from the Debt Service Fund to promote expanded prenatal diagnosis of mental retardation and related defects by the Greenwood Genetics Center pursuant to Proviso 32.3 of the 1998 Appropriations Act.

## NOTE 21. FUND BALANCE RESERVED FOR CAPITAL PROJECTS

The Department receives approval at various intervals to use excess debt service funds from client fees revenues for capital projects. The funds when collected remain in the debt service fund until they are transferred by the State Treasurer to excess debt service reserve account when capital projects are approved. Funds are transferred by the State Treasurer from the excess debt service reserve account to specific capital project accounts when needed to meet expenditures incurred. The amount of excess debt service funds transferred from the debt service fund to excess debt service reserve in the capital projects fund during the year ended June 30, 1998 was approximately $1,900,000. Approximately $2,100,000 was transferred from excess debt service reserve to specific capital projects accounts to meet expenditure needs during the year ended June 30, 1998.

## NOTE 22. FUND BALANCE RESERVED FOR WORK ACTIVITIES

Proviso 32.1 of the 1998 Appropriations Act authorized the Department to retain funds earned from production contracts of Work Activity Training Programs for individuals with mental retardation and related disabilities to use for other operating expenses and/or permanent improvements of these Work Activity Training Programs.

## NOTE 23. TRANSACTIONS WITH STATE ENTITIES

The Department has significant transactions with the State of South Carolina and various State agencies. As required by Section 44-20-355 of the 1976 Code of Laws of South Carolina, as Amended, the Department collected a $8.50 per day Patient Day Fee from all State Intermediate Care Facilities for the Mentally Retarded and remitted the fees to the General Fund of the State. The amount collected and remitted in the fiscal year end June 30, 1998 was approximately $7,600,000.

Services received at no cost from State agencies include maintenance of certain accounting records and payroll and disbursement processing from the Comptroller General; check preparation, banking, and investment functions from the State Treasurer; legal services from the Attorney General; grants services from the Governor's Office; and records storage from the Department of Archives and History. Other services received at no cost from the various divisions of the South Carolina State Budget and Control Board include retirement plan administration, insurance plans administration, audit services, personnel management, assistance in the preparation of the State Budget and record keeping and review and approval of certain budget amendments, procurement services and other centralized functions.

The Department had financial transactions with various other State agencies during the fiscal year. Significant payments were made to divisions of the South Carolina State Budget and Control Board for retirement and insurance plans contributions, insurance coverage, telephone, and interagency mail and supplies. Significant payments were also made for unemployment and worker's compensation coverage for employees. The amounts of 1998 expenditures applicable to related party transactions are not readily available. The approximately $100,000 due to other state agencies represents an amount paid subsequent to fiscal year end to various agencies.

The Department provided no significant services to any other State agencies during the fiscal year ended June 30, 1998.

## NOTE 24. RISK MANAGEMENT

The Department is exposed to various risks of loss and maintains State or commercial insurance coverage for certain of those risks. Management believes such coverage is sufficient to preclude any significant uninsured losses for the covered risks. There were no significant reductions in insurance coverage from coverage in the prior year. Settled claims have not exceeded this coverage in any of the past three years. The Department pays insurance premiums to certain other State agencies and commercial insurers to cover risks that may occur in normal operations. The insurers promise to pay to or on behalf of the insured for covered economic losses sustained during the policy period in accord with insurance policy and benefit program limits except for the deductibles.

State management believes it is more economical to manage certain risks internally and to set aside assets for claim settlement. Several State funds accumulate assets and the State itself assumes substantially all risks for the following:

1. Claims of State employees for unemployment compensation benefits (Employment Security Commission);
2. Claims of covered employees for workers' compensation benefits for job-related illnesses or injuries (State Accident Fund);
3. Claims of covered public employees for health and dental insurance benefits (Office of Insurance Services); and
4. Claims of covered public employees for long-term disability and group-life insurance benefits (Office of Insurance Services).

Employees elect health coverage through either a health maintenance organization or through the State's self-insured plan. All of the other coverages listed above are through the applicable State self-insurance plan except dependent and optional life premiums which are remitted to commercial carriers.

The Department and other entities pay premiums to the State's Insurance Reserve Fund (IRF) which issues policies, accumulates assets to cover the risks of loss, and pays claims incurred for covered losses related to the following assets, activities, and/or events:

1. Theft of, damage to, or destruction of assets;
2. Real property, its contents, and other equipment;
3. Motor vehicles;
4. Torts;
5. Natural disasters; and
6. Medical malpractice claims against covered hospitals and employees.

The IRF is a self-insurer and purchases reinsurance to obtain certain services and specialized coverage and to limit losses in the areas of property, boiler and machinery, automobile liability, and medical professional liability insurance. The IRF's rates are determined actuarially.

The Department self insures for collision damage to Department owned vehicles because it estimates the cost of repairs will be less than the cost of insurance. No material payments for collision damage to Department owned vehicles were made in the fiscal year ended June 30, 1998.

The Department obtains up to $200,000 per occurrence coverage through a commercial insurer for employee fidelity bond insurance for all employees for losses arising from theft or misappropriation. The Department self insures above this amount because it feels the likelihood of loss is remote. No payments for uninsured losses were made during the fiscal year ended June 30, 1998.

The Department has recorded insurance premium expenditures in the applicable programmatic expenditure.

## NOTE 25. THE YEAR 2000 ISSUE

The year 2000 issue arises because most computer software programs allocate two digits to the "year" date field on the assumption that the first two digits will be "19". Without reprogramming, such programs will interpret, for example, the year 2000 as the year 1900. Also, some programs may be unable to recognize that the year 2000 is a leap year.

The year 2000 issue may affect electronic equipment containing computer chips that have date recognition features - such as environmental systems, elevators, and vehicles - as well as computer software programs. In addition, the year 2000 issue affects not only computer applications and equipment under the department's control but also the systems of other entities with which the Department transacts business, including the central state accounting systems which are used to make all payroll and other payments. Some of the Department's systems/equipment affected by the year 2000 issue are critical to the continued and uninterrupted operations of the Department.

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that the Department is or will be year 2000 ready, that the Department's remediation efforts will be successful in whole or in part, or that parties with whom the Department does business, including the central state accounting systems, will be year 2000 ready.

The Department's Division of Information Resources Management began in 1997 a continuing assessment of the year 2000 issue and its affects on the operations of the Department. The Department has continued to monitor on a quarterly basis the need for, and progress of, remediation efforts, and the status of contingency plans developed to address the possibility that year 2000 failures might adversely affect systems critical to the Department's operations.

Department employees have performed substantially all of the work that has been undertaken to date toward addressing the Department's year 2000 issue. Although the Department contracted during the fiscal year ended June 30, 1998, with an external vendor for assistance in addressing one such issue, there were no unpaid commitments associated with this contract as of June 30, 1998. Subsequent to June 30, 1998, however, the Department entered into some new vendor contracts for year 2000 assistance.

The Department has identified 65 computer systems that are mission-critical (that is, critical to conducting operations). These systems affect consumer safety and health, financial, and personnel aspects of the Department's operations. The Department is subjecting those systems and equipment to the following stages of work to address year 2000 issues:

- Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
- Assessment stage - Identifying the systems and components for which year 2000 compliance work is needed.
- Remediation stage - Making changes to systems and equipment.
- Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

The Department has completed the awareness stage for all of its mission-critical systems. The assessment stage has been completed for all of those systems except for the financial accounting system, the Medicaid billing system, and one regional pharmacy system. The remediation stage also has been completed for all remaining systems except the residential banking and billing system. The validation/testing stage as well has been completed for all other remaining systems except the payroll/personnel system.

## NOTE 26. VOLUNTARY SEPARATION PROGRAM

Proviso 32.9 of the 1997-98 Appropriations Act allowed the Department to develop and implement a staff reduction program which included separation incentive payments. The Department implemented such a program during the 1997-98 fiscal year. Under the program, approximately 110 employees terminated employment and approximately $2,400,000 in separation incentive payments were made. There was no future liability for additional separation incentive payments at fiscal year end.

## NOTE 27. ACCOUNTING CHANGES

Effective July 1, 1997, the Department adopted Governmental Accountings Standards (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. This Statement requires that most investments of governmental entities be stated at fair value rather than at cost. For internal investment pools, this Statement requires that the equity position of each fund that sponsors the pool to be reported as assets in those funds. The Department has restated its beginning fund balances as of July 1, 1997 for changes resulting from adoption of Statement No. 31, which are disclosed in the following schedule:

| | Fund Balances - June 30, 1997 | | |
|---|---|---|---|
| | As Previously Reported | Restatement Adjustment | As Restated |
| General Fund | $ 13,173,532 | $ 134,126 | $ 13,307,658 |
| Debt Service Fund | $ 4,965,249 | $ 1,099 | $ 4,966,348 |

As a result of this accounting change, investment income reported includes interest, realized gains (losses) and unrealized gains (losses). If the adoption of Statement No. 31 were retroactive to June 30, 1996, the investment income for the General Fund and Debt Service Fund would have increased by $122,765 and $45,672 respectively for the year ended June 30, 1997.

For the Agency Fund, the cash and cash equivalents balance and the related liability for funds held in trust for clients were each increased $5,562 as of June 30, 1997 to reflect the change resulting from the adoption of Statement No. 31.

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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the financial statements of the South Carolina Department of Disabilities and Special Needs (the Department) as of and for the year ended June 30, 1998 and have issued our report thereon dated March 23, 1999 on which our opinion was qualified because insufficient audit evidence exists to support the Department's year 2000 disclosures. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the Commission members and management of the South Carolina Department of Disabilities and Special Needs, federal awarding and pass-through agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Columbia, South Carolina
March 23, 1999

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

**Compliance**

We have audited the compliance of the South Carolina Department of Disabilities and Special Needs (the Department) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 1998. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred.
An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.
Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 1998.

**Internal Control Over Compliance**

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of the Commission members and management of the South Carolina Department of Disabilities and Special Needs, federal awarding and pass-through agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Columbia, South Carolina
March 23, 1999

# SOUTH CAROLINA DEPARTMENT OF DISABILITIES AND SPECIAL NEEDS

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE FISCAL YEAR ENDED JUNE 30, 1998

### SUMMARY OF AUDITORS' RESULTS

1. A qualified opinion dated March 23, 1999 on the financial statements of the Department for the year ended June 30, 1998 was issued.

2. No reportable conditions in internal control over financial reporting were disclosed during the audit of the financial statements.

3. No reportable conditions in internal control over major programs are reported.

4. No instances of noncompliance that were material to the financial statements were noted during the audit.

5. An unqualified opinion on compliance for major programs dated March 23, 1999 was issued.

6. There are no findings required to be reported under Section .510(a) of OMB Circular A-133.

7. The major programs of the Department are Child Care and Development Block Grant (CFDA 93.575) and Centers of Disease Control and Prevention - Investigations and Technical Assistance (CFDA 93.283).

8. The dollar threshold used to distinguish between Type A and Type B programs was $300,000.

9. The Department was determined to be a low risk auditee.

### FINDINGS - FINANCIAL STATEMENT AUDIT

None.

### FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

No findings and questioned costs for federal awards required to be reported under Sections .510(a) of OMB Circular A-133 are reported.