South Carolina Department of Mental Health

Independent Accountants' Report on

Applying Agreed-Upon Procedures

for the year ended June 30, 2006

State of South Carolina

Office of the State Auditor

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June 28, 2007

The Honorable Mark Sanford, Governor
and
Members of the Commission
South Carolina Department of Mental Health
Columbia, South Carolina

This report on the application of certain agreed-upon procedures to the accounting records of the South Carolina Department of Mental Health for the fiscal year ended June 30, 2006, was issued by Scott McElveen, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,

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

RHGjr/cwc

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SCOTT McELVEEN LLP

Independent Accountants' Report on Applying Agreed-Upon Procedures

Mr. Richard H. Gilbert, Jr., CPA
Deputy State Auditor
State of South Carolina
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the Members of the Board of Commissioners and management of the South Carolina Department of Mental Health (the "Agency") and the South Carolina Office of the State Auditor (the "State Auditor"), solely to assist you in evaluating the performance of the Agency for the fiscal year ended June 30, 2006, in the areas addressed. The Agency's management is responsible for its financial records, internal controls and compliance with State laws and regulations. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified parties in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and the associated findings are as follows:

1. **Cash Receipts and Revenues**

   - We inspected 25 randomly selected recorded receipts to determine if these receipts were properly described and classified in the accounting records in accordance with the Agency's policies and procedures and State regulations.

   - We inspected 10 randomly selected recorded receipts before and after year-end 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 remittances were supported by law.

   - We compared current year recorded revenues at the subfund and object code level from sources other than State General Fund appropriations to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that revenue was classified properly in the Agency's accounting records. The scope was based on agreed-upon materiality levels ($380,000 – general fund, $350,000 – earmarked fund, and $98,000 – federal fund) and +/- 10 percent.

Our findings as a result of these procedures are presented in Sections A and B in the Accountants' Comments section of this report.

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

   - We inspected 25 randomly selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records in accordance with the Agency's policies and procedures and State regulations, were bona fide disbursements of the Agency, and were paid in conformity with State laws and regulations; and if the acquired goods and/or services were procured in accordance with applicable laws and regulations.

   - We inspected 10 randomly selected recorded non-payroll disbursements before and after year-end to determine if these disbursements were recorded in the proper fiscal year.

   - We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded expenditures were in agreement.

   - We compared current year expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that expenditures were classified properly in the Agency's accounting records. The scope was based on agreed-upon materiality levels ($380,000 – general fund, $350,000 – earmarked fund, and $98,000 – federal fund) and +/- 10 percent.

   We found no exceptions as a result of the procedures.

3. **Payroll Disbursements and Expenditures**

   - We inspected 25 randomly selected recorded payroll disbursements to determine if the selected payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements and processed in accordance with the Agency's policies and procedures and State regulations.

   - We inspected 5 randomly selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS.

   - We inspected payroll transactions for 5 randomly selected new employees and 5 randomly selected individuals who terminated employment to determine if the employees were added and/or removed from the payroll in accordance with the Agency's policies and procedures, that the employee's first and/or last pay check was properly calculated and that the employee's leave payout was properly calculated in accordance with applicable State law.

   - We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement.

- We compared current year payroll expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that expenditures were classified properly in the Agency's accounting records. The scope was based on agreed-upon materiality levels ($380,000 – general fund, $350,000 – earmarked fund, and $98,000 – federal fund) and +/- 10 percent.

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

We found no exceptions as a result of the procedures.

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

- We inspected 5 recorded journal entries, 5 operating transfers, and 5 appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, the purpose of the transactions was documented and explained, the transactions were properly approved, and were mathematically correct; and the transactions were processed in accordance with the Agency's policies and procedures and State regulations.

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

5. **General Ledger and Subsidiary Ledgers**

- We inspected 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 selected entries were processed in accordance with the Agency's policies and procedures and State regulations.

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

6. **Reconciliations**

- We obtained all of the monthly reconciliations prepared by the Agency for the year ended June 30, 2006, and inspected selected reconciliations of balances in the Agency's accounting records to those in STARS as reflected in the Comptroller General's reports to determine if accounts reconciled. For the selected reconciliations, we determined if they were timely performed and properly documented in accordance with State regulations; recalculated the amounts, agreed the applicable amounts to the Agency's general ledger; agreed the applicable amounts to the STARS reports; determined if reconciling differences were adequately explained and properly resolved; and determined if necessary adjusting entries were made in the Agency's accounting records and/or in STARS.

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

7. **Appropriation Act**

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

   We found no exceptions as a result of the procedures.

8. **Closing Packages**

   - We obtained copies of closing packages as of and for the year ended June 30, 2006, prepared by the Agency and submitted to the State Comptroller General. We inspected them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements and if the amounts reported in the closing packages agreed with the supporting workpapers and accounting records.

   We found no exceptions as a result of the procedures.

9. **Schedule of Federal Financial Assistance**

   - We obtained a copy of the Schedule of Federal Financial Assistance for the year ended June 30, 2006, prepared by the Agency and submitted to the State Auditor. We inspected it to determine if it was prepared in accordance with the State Auditor's letter of instructions; and if the amounts agreed with the supporting workpapers and accounting records.

   We found no exceptions as a result of the procedures.

10. **Status of Prior Findings**

    - We inquired about the status of the findings reported in the Accountants' Comments section of the Independent Accountants' Report on the Agency resulting from our engagement for the fiscal year ended June 30, 2005, to determine if the Agency had taken corrective action.

    Our findings as a result of these procedures are presented in Section C in the Accountants' Comments section of this report.

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor, Members of the Board of Commissioners, management, and the South Carolina Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
June 18, 2007

ACCOUNTANTS' COMMENTS

SECTION A – VIOLATIONS OF STATE LAWS, RULES, OR REGULATIONS

Management of each State agency is responsible for establishing and maintaining internal controls to ensure compliance with State Laws, Rules or Regulations. The procedures agreed to by the Agency require that we plan and perform the engagement to determine whether any violations of State Laws, Rules or Regulations occurred. The conditions described in this section have been identified as violations of State Laws, Rules or Regulations.

Untimely Deposit of Receipts

Section 72.1 of the fiscal year 2005-06 Appropriation Act requires revenues to be remitted to the State Treasurer at least once each week, when practical. One out of the twenty-five deposits tested was not deposited within seven days as required by Agency procedure and State law. Resident rent receipt (receipt # 117349), prepared by a community mental health center, for the week of May 11, 2006, totaling $4,333, was deposited on May 31, 2006.

We recommend all Agency personnel who handle cash receipts be provided training to ensure that they are aware of current State law pertaining to the deposit of cash receipts. In addition, the Agency should develop and implement procedures to ensure that cash receipts are deposited timely as defined by Section 72.1 of the Appropriation Act.

Reconciliations

Monthly reconciliation of the Agency's SAP to STARS is required by the STARS manual in proviso 2.1.7.20. Our testing of monthly reconciliations for receipts revealed that the Agency had not performed any of the monthly reconciliations for fiscal year 2006 with regards to receipts.

Our testing of monthly reconciliations for general and earmarked expenditures revealed that only the reconciliation for month thirteen was prepared. This reconciliation was signed off by the preparer and reviewer, but it was not prepared until June 2007. Further, the differences found during the reconciliation process were not adequately explained.

Our testing of monthly reconciliations for cash revealed that eleven of the thirteen reconciliations were not prepared in a timely manner.

Sound internal controls require that all reconciliations be properly prepared in a timely manner with adequate documentation to explain differences included with the reconciliations. We recommend that the Agency obtain the necessary reports, and information technology assistance, as needed, to successfully perform the monthly reconciliations.

SECTION B - OTHER COMMENT

The condition described in this section has been identified while performing the agreed-upon procedures but is not considered a violation of State Laws, Rules or Regulations.

Improper Classification of Revenue

During the performance of analytical procedures on revenues, it was discovered that revenue from the sale of land was recorded to Miscellaneous Revenue (Object code 7201) in the amount of $797,557, when it should have been recorded to Sale of Land (Object code 7851). The sale of land was recorded correctly by sub fund code. However, the land, with a capitalized cost of $1,060, was not taken off the books and was still included on the Capital Assets Closing Package.

The improper coding was due to failure of staff to follow-up with management on the proper classification for this particular transaction. This transaction was flagged by the mental health center, with a question regarding classification. The individual responsible for making this determination was not available at that time, and the accounting staff failed to follow-up with this individual or anyone else in management. The oversight could cause inaccurate presentation of revenue sources, improper budgeting, and misstatement of assets on the Capital Assets Closing Package.

We recommend that Agency staff be better informed to communicate with management when they are not sure about how to classify a particular transaction. Better communication between staff and management will mitigate the potential for accounting errors and misclassifications.

SECTION C - STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountants' Comments section of the Independent Accountants' Report on the Agency for the fiscal year ended June 30, 2005. We determined that the Agency has made some progress toward correcting the findings as noted in the June 30, 2005 report. However, additional progress is required to ensure compliance with state laws, rules and regulations, and to ensure sound internal controls. Therefore the prior year findings have been repeated in Section A of this report. We recommend that the Agency continue to take corrective action and follow the recommendations as outlined in Sections A and B of this report.

2005 Comment Title	***2006 Comment Title***
Untimely Deposit of Receipts	Untimely Deposit of Receipts
Reconciliations	Reconciliations

DMH

South Carolina Department of Mental Health

2414 Bull Street/P.O. Box 485
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Information: (803) 898-8581

John H. Magill
State Director of Mental Health

MISSION STATEMENT
To support the recovery of people with mental illnesses.

June 26, 2007

Scott McElveen, LLP
P.O. Box 8388
Columbia, SC 29202

Dear Madam/Sir:

This letter is in response to the audit report of Agreed-Upon Procedures for the year ended June 30, 2006. The headings shown below correspond to the same comment headings contained in your report.

Untimely Deposit of Receipts

Timely deposit of cash receipts have been required by the Department of Mental Health and Financial Services for many years. Financial Services Policies and Procedures Manual established written policies and procedures over a decade ago and copies were published and provided to all financial divisions, as well as the manual being 'on-line' for all DMH employees. The requirements and procedures are also taught in the DMH Cashier Training courses available to any financial division. We will again emphasize to the DMH mental health centers the need for timely deposit of cash receipts.

Reconciliations

We agree with the audit comment that the Department of Mental Health has not prepared monthly reconciliations of receipts and expenditures as required by the Office of the Comptroller General STARS manual. While the implementation of the new financial system (SAP) also occurred during this time period, the Comptroller General's Office and the State CIO were aware of the problems encountered in this area and actively assisted DMH in this endeavor. Also, the accounting department has experienced excessive employee turnover during this period, resulting in extreme difficulty in locating and hiring of experienced and knowledgeable staff. In September of 2006, an individual was hired with extensive Excel experience which is proving very useful in the improvement of the reconciliation process.

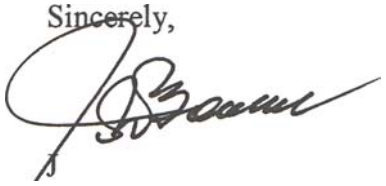
Reconciliations are necessary as each agency must reconcile their separate financial records with other similar but separate financial records maintained by the Comptroller General. It should be noted that when the Comptroller General begins utilizing the SAP financial system, many of the required reconciliations will no longer be necessary. Currently the South Carolina Enterprise Information System (SCEIS) is scheduled to "go live" for central government in the near future. Upon completion of this effort, DMH and the Comptroller General will be using the same financial data base, eliminating the necessity to perform many required reconciliations.

We will continue efforts to prepare reconciliations on a current basis.

Improper Classification of Revenue

We agree with the audit comment and staff is encouraged to communicate with management when classification questions arise. We will also begin a semi-annual review of revenue object codes reflected in the "Sale of Property" sub fund to ensure revenue is properly coded and that items are properly accounted for in the Capital Assets Closing Package.

Sincerely,



John D. Bourne, CPA
Director of Financial Services

JDB/lwf