

State of South Carolina



Office of the State Auditor

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June 30, 2005

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

This report resulting from the application of certain agreed-upon procedures to certain accounting records of the South Carolina Office of the Adjutant General for the fiscal year ended June 30, 2004, 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,

A handwritten signature in black ink, appearing to read "Tom Wagner".

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/trb

South Carolina Office of the Adjutant General

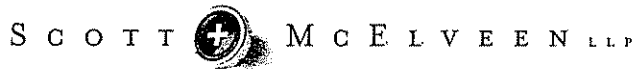
Independent Accountants' Report on

Applying Agreed-Upon Procedures

for the year ended June 30, 2004

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Independent Accountants' Report on Applying Agreed-Upon Procedures

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

We have performed the procedures described below, which were agreed to by the South Carolina Office of the State Auditor (the "State Auditor"), solely to assist you in evaluating the accounting records of the South Carolina Office of the Adjutant General (the "Agency") for the fiscal year ended June 30, 2004, 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 selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the selected receipt transactions were adequate to detect errors and/or irregularities.
- We inspected selected recorded receipts to determine if these receipts were recorded in the proper fiscal year.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement.
- We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law.
- We compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year and we used estimations and other procedures to evaluate the reasonableness of collected and recorded amounts by revenue account.

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Section A in the Accountants' Comments sections of this report.

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2. Non-Payroll Disbursements and Expenditures

- We inspected selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the Agency, and were paid in conformity with State laws and regulations; if the acquired goods and/or services were procured in accordance with applicable State laws and regulations; and if internal controls over the selected disbursement transactions were adequate to detect errors and/or irregularities.
- We inspected selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded expenditures were in agreement.
- We compared current year expenditures to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account.

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Section A in the Accountants' Comments sections of this report.

3. Payroll Disbursements and Expenditures

- We inspected selected recorded payroll disbursements to determine if the selected payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the selected payroll transactions were adequate to detect errors and/or irregularities.
- We inspected selected recorded payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS.
- We inspected payroll transactions for selected new employees and those who terminated employment to determine if internal controls over these transactions were adequate.
- 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 recorded payroll expenditures to those of the prior year; 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 to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account.

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

4. Journal Entries, Operating Transfers and Appropriation Transfers

- We inspected selected recorded journal entries, operating transfers, and appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate to detect errors and/or irregularities.

We found no exceptions as a result of the procedures.

5. General Ledger and Subsidiary Ledgers

- We inspected selected entries and monthly totals in the subsidiary records of the Agency to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger, and the internal controls over the selected transactions were adequate to detect errors and/or irregularities.

We found no exceptions as a result of the procedures.

6. Reconciliations

- We obtained all monthly reconciliations prepared by the Agency for the year ended June 30, 2004, and inspected selected reconciliations of balances in the Agency's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. 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 amount 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.

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

7. Compliance

- We confirmed through inspection of payroll and non-payroll disbursement vouchers, cash receipts and other documents, inquiry of agency personnel and or observation of agency personnel performing their assigned duties, the Agency's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 2004.

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

8. Closing Packages

- We obtained copies of all closing packages as of and for the year ended June 30, 2004, 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; if the amounts were reasonable; and if they agreed with the supporting work papers and accounting records.

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

9. Schedule of Federal Financial Assistance

- We obtained a copy of the schedule of federal financial assistance for the year ended June 30, 2004, 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; if the amounts were reasonable; and if they agreed with the supporting work papers and accounting records.

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

10. Status of Prior Findings

- We inquired about the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the Agency resulting from their engagement for the fiscal year ended June 30, 2002, to determine if adequate corrective action has been taken. We applied no procedures to the Agency's accounting records and internal controls for the year ended June 30, 2003.

Our findings as a result of these procedures are presented in Section C in the Accountants' Comments sections 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 areas, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor and the management of 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
May 25, 2005

SECTION A – MATERIAL WEAKNESS AND/OR VIOLATIONS OF STATE LAWS, RULES, OR REGULATIONS

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

The conditions described in this section have been identified as violation of State Laws, Rules, or Regulations, but is not considered to be a material weakness.

Untimely Deposit of Receipts

Cash is submitted to armory personnel, at the various armories throughout the state, who are responsible for depositing the cash in the bank within seven days of receipt. After the deposit is made, the deposit slips are sent to the finance department. In three cases, the armory personnel held the cash for more than seven days prior to deposit. In one of these instances, the deposit slip was not forwarded to the finance department in a timely manner. This caused a receipt to be recorded in the wrong fiscal year. Under these circumstances, there is an opportunity for misappropriation and no means of detection. State law is also violated, and the State is missing out on the opportunity to earn interest on the deposited cash.

We recommend that the Agency develop and implement control procedures to strengthen internal controls over cash receipts and revenues at the various armories to ensure that all receipts are accounted for, deposited, and recorded timely in accordance with the 2004 Appropriation Act, the Agency's policies, and generally accepted accounting principles (GAAP).

Expenditure Allocation

All allocations among state, federal, and earmarked sub funds should have adequate supporting documentation. In testing disbursements, we noted an instance where the Emergency Management Division ("Division") submitted a voucher request for an expenditure that the division allocated among state, federal, and earmarked sub funds. The Division could not provide the finance department with any support for the allocation percentages used on the voucher. The allocation percentages on the voucher were not in agreement with the allocation guidelines of the earmarked and federal grants that the expenditure was allocated to and no explanation could be provided.

We recommend that allocation guidelines be followed for the respective grants to which expenditures are allocated unless the requesting party can provide adequate documentation for an alternate allocation.

Payroll Duties

The Human Resource Department is responsible for setting up all new hires into the payroll system, except Armory Sitters and Youth Challenge Cadets. When new employees are set up in the system, their personal information, pay rate, and all allowable deductions are entered into the system. Employees in the finance department are responsible for entering new hire information into the system for the Armory Sitters and Youth Challenge Cadets. This creates the opportunity for personnel responsible for processing and/or reviewing payroll data to create fictitious employees.

In addition, employees in the finance department have system access that allows them to change pay rates for any employee. As a result, certain finance department employees can change pay rates without authorization or knowledge of superiors. The system access and human resource duties assigned to certain finance department employees creates an insufficient segregation of duties. Payroll reports are reviewed by the Director of Fiscal Systems to compensate for the lack of segregation, but this is insufficient.

We recommend that these duties be properly segregated. System access for the payroll employee of the finance department should be restricted to the ability to make a one-time pay rate change only. This is necessary for the proper pay rates for employees who are terminated with compensation for annual leave. All new hires should be processed by the human resource department only.

Reconciliations

We reviewed the reconciliations for all funds and projects noting that the revenue and expenditure reconciliations were properly performed, signed, and dated by the preparer in a timely manner with the exception of one fund. The Agency could not provide the reconciliations of this one sub fund for seven months of the fiscal year. The Agency did not properly complete the cash reconciliations for any fund. There were reconciling differences each month that were not adequately explained. Also, none of the monthly reconciliations were signed and dated by the reviewer.

We recommend the Agency continue the process of completing reconciliations for all funds and projects to ensure compliance with STARS Manual requirements and to identify and correct errors in its accounting records and/or STARS as necessary. We also recommend that all reconciliations be reviewed and approved in writing by an appropriate official other than the preparer. Despite these findings, the Agency's reconciliation process has improved significantly from prior years.

Capital Assets Closing Package

The State Comptroller General's Office obtains GAAP data from agency-prepared closing packages for the State's financial statements. Section 1.7 of the GAAP Closing Procedures Manual (GAAP Manual) states the each agency is responsible for submitting accurate and complete closing package forms that are completed in accordance with instructions and further states that, "The accuracy of closing package data is extremely important." Section 1.8 states, "Agencies should keep working papers to support each amount they enter on each closing package form." Section 3.9 of the GAAP Manual requires agencies to maintain full documentation to support each number on the closing package.

We reviewed and tested the capital asset additions reconciliation form and determined the amounts reported to be reasonable. The total asset additions agreed to the detailed support. We also reviewed the capital assets and accumulated depreciation summary forms to determine whether the amounts were reasonable and adequately supported by Agency records. Other than current year capital asset additions and retirements for machinery and equipment, the Agency was not able to provide sufficient supporting documentation for the amounts and ending balances of the assets reported on the summary forms. In addition, the ending balances on the summary form did not agree to the Agency's property inventory records. Agency personnel told us that an inventory of the Agency's capital assets had not been performed in several years. South Carolina Code of Laws Section 10-1-140 requires the head of each agency to make an inventory of all personal property under his supervision each fiscal year.

Apparently, the Agency's accounting department does not currently have control over the Agency's capital assets, and as a result, the assets are not being properly controlled and safeguarded. It is critical to the control and safeguarding of these capital assets that the Agency's accounting department have control over the capital assets. We have never seen another State agency or any other entity whose accounting department did not have control over capital assets.

We recommend that the Agency redirect control over its capital assets to the accounting department so that the department can develop and implement procedures to ensure that its financial information is properly identified and that its accumulated balances and transactions are reported in accordance with GAAP and GAAP Manual instructions. Such procedures should ensure that only assets meeting the appropriate capitalization criteria be reported as capital assets. Furthermore, the Agency should perform an inventory of all capital assets and adjust its accounting records to properly reflect those assets.

Other Closing Packages

As noted in the State Auditor's potential management comments in the last agreed-upon procedures engagement, the reviewer of the closing package did not use the reviewer checklist as required by GAAP Closing Package Instructions. We reviewed the fiscal year 2004's closing package and noted the reviewer checklist was not used for any closing packages. The GAAP Manual recommends an effective review of each closing package and the underlying working papers to minimize closing package errors and omissions. To assist each agency in performing effective reviews, the State Comptroller General's Office requires a reviewer checklist to be completed for each closing package submitted.

We also noted that the Grants Disallowance Closing Package was not signed by the preparer. In addition, the Compensated Absences, Grants Disallowances, Capital Assets Overview, Capital Assets and Accumulated Depreciation, and the Capital Assets Additions were not submitted to the Comptroller General's Office by the required due date.

We recommend that the preparer sign all closing package forms, the reviewer review all closing packages using the reviewer's checklist, and all closing packages be submitted by the required due date to the Comptroller General Office. An effective review is essential to minimizing closing package errors.

SECTION B – OTHER WEAKNESSES NOT CONSIDERED MATERIAL

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

Schedule of Federal Financial Assistance

The Schedule of Federal Financial Assistance and the internal control questionnaires were not submitted to the Office of the State Auditor by the deadlines stated in the instructions. Supplemental schedules requested in the instructions were not submitted to the Office of the State Auditor.

We recommend that the Agency prepare the requested schedules and submit them by the required date.

SECTION C – STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on the findings reported in the Accountants' Comments Section of the State Auditor's Report on applying agreed upon procedures for the fiscal year ended June 30, 2002, and dated July 14, 2003. We applied no procedures to the Agency's accounting records and internal controls for the year ended June 30, 2003. We determined that the Agency has taken adequate corrective action on each of the findings except for the following which have been repeated in Section A of this report.

2002 Comment Title

Deposits

Reconciliations

Capital Asset Closing Package

2004 Comment Title

Untimely Deposits of Receipts

Reconciliations

Capital Asset Closing Package

The State of South Carolina
Military Department



Office of the Adjutant General

STANHOPE S SPEARS
MAJOR GENERAL
THE ADJUTANT GENERAL

1 NATIONAL GUARD ROAD
COLUMBIA, S C. 29201-4766

JOHNA SHULER
DEPUTY ADJUTANT GENERAL
STATE OPERATIONS

June 27, 2005

Mr. Don Mobley
Scott McElveen, L.L.P.
PO Box 8388
Columbia, South Carolina 29202

Dear Mr. Mobley:

The Office of the Adjutant General has completed its review of the agreed-upon procedures report for the year ending June 30, 2004 and authorizes the release of this report. I am enclosing the Agency's response to your comments, which will be added to your report.

The Agency has made many improvements and will continue to implement your recommendations. We appreciate the professional work of your staff and the assistance they provided this Agency.

Sincerely,

A handwritten signature in cursive script that reads "Susan M. Simmons".

Susan M. Simmons, CPA
Director of Fiscal Systems

Untimely Deposit of Receipts

The Agency has improved its controls over revenues including the deposit process, but it has not eliminated its problems with armory deposits. Army National Guard Armory Managers who turn over frequently make the majority of the Agency's deposits. Therefore, the Agency must continually train new people. The Agency has reissued guidance to the armories and other receipting locations regarding the required controls and procedures. Also, the general ledger accountant and the armory operations coordinator will continue to offer one-on-one and group training on proper procedures.

Expenditure Allocation

The Agency will review its policies on direct and indirect allocation of costs. It will implement controls to ensure that all allocations are properly supported and updated as circumstances dictate.

Payroll Duties

The Adjutant General concurs with the findings and recommendations. The Agency is investigating the recommended restrictions and segregation of duties. Limiting access to only the Human Resource Department may present mechanical limitations because the SABAR system (the Agency's accounting and personnel system) uses shared files. The Agency will seek solutions to ensure sufficient payroll and personnel segregation of duties for all positions, including Armory Sitters and Youth Challenge Cadets to the extent allowed by the SABAR System.

Reconciliations

The Agency has continued to make significant improvements in the reconciliation process in fiscal year 2004. Due to the Agency not being properly reconciled for several years and due to numerous differences existing between SABAR and STARS, it has been a long, difficult process to correct the errors and bring the reconciliations up to date. During fiscal year 2004, most federal subfunds' reconciliations were completed including cash. During fiscal year 2005, all earmarked funds' reconciliations were completed. This brings all reconciliations up to date except for two Emergency Management grants, however there are still a few accounts with reconciled balances that need to be closed. The Agency plans to have all accounts reconciled and closed as appropriate by the end of fiscal year 2006.

The Agency believed that it was more beneficial to have the general ledger accountant help perform the required reconciliations to get current than to sign and approve other staff's work. In fiscal year 2006, all reconciliations will be reviewed and documented by the general ledger accountant.

Capital Assets Closing Package

The Military Department of South Carolina has a complex capital assets structure. Some assets are purchased and owned by the military, some are purchased and owned by the (State) Agency, and some are a combination. The Agency has determined that many of the capital projects done via the (State) Agency will not be assets of the Agency. (Such is the case with capital projects built on 100% federal property at McEntire and McCrady.)