

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

STATE AUDITOR'S REPORT

JUNE 30, 2000

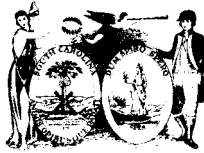
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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

June 5, 2001

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

We have performed the procedures described below, which were agreed to by the management of the South Carolina Office of the Adjutant General (the Agency), solely to assist you in evaluating the performance of the Agency for the fiscal year ended June 30, 2000, in the areas addressed. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures and the associated findings are as follows:

1. We tested selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the tested receipt transactions were adequate. We also tested selected recorded receipts to determine if these receipts were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement. We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law. We compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year to determine the reasonableness of collected and recorded amounts by revenue account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Deposits, Reconciliations, Deferred Revenues, and Data Translation to the State in the Accountant's Comments section of this report.

2. We tested selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records, were bona fide disbursements of the Agency, and were paid in conformity with State laws and regulations and if internal controls over the tested disbursement transactions were adequate. We also tested selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded expenditures were in agreement. 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 for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Expenditures, Reconciliations, Permanent Improvement Project Accounting, and Data Translation to the State in the Accountant's Comments section of this report.
3. We tested selected recorded payroll disbursements to determine if the tested payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the tested payroll transactions were adequate. We tested selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS. We also tested payroll transactions for selected new employees and those who terminated employment to determine if internal controls over these transactions were adequate. 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 performed other procedures such as comparing current year recorded payroll expenditures to those of the prior year; comparing the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computing the percentage distribution of recorded fringe benefit expenditures by fund source and comparing 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. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Reconciliations, and Payroll in the Accountant's Comments section of this report.
4. We tested selected recorded journal entries and all operating and appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, were adequately documented and explained, were properly approved, and were mathematically correct; and the internal controls over these transactions were adequate. The journal entries selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control and Accounting Transactions in the Accountant's Comments section of this report.

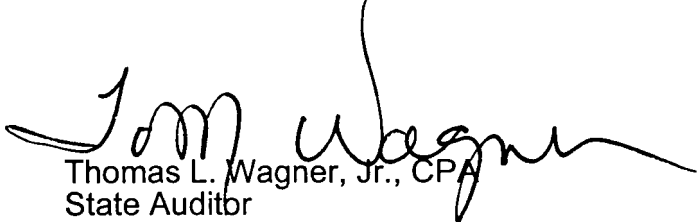
5. We tested selected entries and monthly totals in the subsidiary records of the Agency to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and the internal controls over the tested transactions were adequate. The transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control and Reconciliations in the Accountant's Comments section of this report.
6. We obtained all monthly reconciliations prepared by the Agency for the year ended June 30, 2000, and tested 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 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 reconciliations selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Reconciliations, and Data Translation to the State in the Accountant's Comments section of this report.
7. We tested the Agency's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 2000. Our findings as a result of these procedures are presented in Deposits, Expenditures, Reconciliations, Closing Packages, Deferred Revenues, Petty Cash Checking Accounts, Payroll, Employee Blanket Bond, Schedule of Federal Financial Assistance, Public Assistance, and Permanent Improvement Project Accounting in the Accountant's Comments section of this report.
8. We reviewed the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the Agency resulting from our engagement for the fiscal year ended June 30, 1999, to determine if adequate corrective action has been taken. Our findings as a result of these procedures are presented in various comments in Section A of the Accountant's Comments as described in Section B – Status of Prior Findings in the Accountant's Comments section of this report.
9. We obtained copies of all closing packages as of and for the year ended June 30, 2000, prepared by the Agency and submitted to the State Comptroller General. We reviewed them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our findings as a result of these procedures are presented in Internal Control, Closing Packages, and Petty Cash Checking Accounts in the Accountant's Comments section of this report.

Major General Stanhope S. Spears
Adjutant General
State of South Carolina
June 5, 2001

10. We obtained a copy of the schedule of federal financial assistance for the year ended June 30, 2000, prepared by the Agency and submitted to the State Auditor. We reviewed it to determine if it was prepared in accordance with the State Auditor's letter of instructions; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our findings as a result of these procedures are presented in Reconciliations, Schedule of Federal Financial Assistance, and Data Translation to the State in the Accountant's Comments section of this report.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified areas, accounts, or items. Furthermore, we were not engaged to express an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express such opinions. Had we performed additional procedures or had we conducted an audit or review of the Agency's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Adjutant General and of the management of the South Carolina Office of the Adjutant General and is not intended to be and should not be used by anyone other than these specified parties.


Thomas L. Wagner, Jr., CPA
State Auditor

ACCOUNTANT'S COMMENTS

SECTION A - MATERIAL WEAKNESSES AND/OR VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

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

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

INTRODUCTORY COMMENTS

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

For fiscal year 2000, the Agency had approximately \$8.5 million appropriations and 64 authorized full-time equivalent positions (FTEs) in general funds and approximately \$29 million appropriations and 187 FTEs in total funds. Most of the difference in general and total funds is federal funding for military operations, maintenance, and construction. In addition to the military operations, the Agency also has an emergency preparedness division.

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

INTERNAL CONTROL

Introduction

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

Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. An entity's internal controls are comprised of the following five interrelated components.

1. Control Environment sets the tone of an organization influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. Risk Assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
3. Control Activities are the policies and procedures that help ensure that management's directives are carried out.
4. Information and Communication are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
5. Monitoring is a process that assesses the quality of internal control performance over time.

The following subsections further define the five components of internal control and describe the Agency weaknesses and our recommendations.

Control Environment

As described above the control environment sets the tone of the organization. Factors comprising the control environment include commitment to competence, organizational structure, assignment of authority and responsibility, and human resource policies and practices.

In many ways the Agency's organizational structure is very similar to a military organization. Many of the Agency's key management have a military background, which is very useful with respect to the Agency's federal mission. However, the Agency is a State agency and it also requires staff members who are familiar with State government laws, rules, and regulations. As a result of employee turnover, etc., the Agency has lost key personnel who had a considerable amount of State experience. The loss of State experience has significantly impacted the finance department where familiarity with the State's accounting system (STARS) and State laws, rules and regulations is essential. Also, it does not appear that management has taken steps to ensure that new employees have received adequate training with respect to State requirements. In addition, the Agency has not taken steps to correct the findings reported in the Auditor's Comments section of our agreed-upon procedures report for the year

ended June 30, 1996, or findings and questioned costs reported in the Statewide Single Audit Report for the year ended June 30, 1997. As a result, the same or similar comments are repeated throughout this document.

Risk Assessment

An entity's risk assessment for financial reporting purposes is its identification, analysis and management of risks relevant to the preparation of financial statements that are fairly presented in conformity with generally accepted accounting principles. Risks relevant to financial reporting include external and internal events and circumstances that may occur and adversely affect an entity's ability to record, process, summarize, and report financial data consistent with the assertions of management (e.g., changes in the operating environment, changes in personnel, etc.)

The Agency's director of budget and finance was terminated in fiscal year 1997. In July 1997 the Agency named an interim director, filling the vacancy internally. The employee was appointed as the permanent director in April 1998. Between July 1997 and December 1998 the Agency had not filled the vacancy created by the internal promotion. During this time the Agency hired temporary employees or contracted with temporary service agencies to fill positions within the budget and finance department. And as stated earlier, because the employees were not familiar with the STARS and State laws, rules, and regulation it impacted the Agency's ability to process and record accounting transactions.

Control Activities

The control activities include operating policies and procedures, which are clearly written and communicated. Policies and procedures should address the processing of accounting transactions, physical controls, segregation of duties, and identification of changes in laws, rules, and regulations that affect the agency.

The Comptroller General's Policies and Procedures Manual (STARS Manual) provides guidance to agencies on how to process accounting transactions on the STARS. We determined that the STARS Manual used by budget and finance is not current. As a result, the accounts payable staff has been using outdated object codes to define current accounting transactions that it processes on STARS. In addition, the Agency has decentralized its accounting functions by giving more responsibilities to unit personnel throughout the State, but has not provided unit personnel with resources (e.g., training, equipment, etc.) to perform the additional duties. We also noted that independent reviews of transactions were being performed by employees who reported to the preparer, were being performed by personnel that were not familiar with STARS and other State and federal laws, rules, and regulations, or were just not being performed. This breakdown in controls occurred because of employee turnover in budget and finance.

Information and Communication

Activities relevant to financial reporting objectives consist of methods and records established to record, process, summarize, and report entity transactions and to maintain accountability for the related assets, liabilities, and equity. The quality of system-generated information affects management's ability to make appropriate decisions. To be effective the information system should include:

1. An accounting system which provides for separate identification and allocation of transactions according to the entity's separate funding sources;
2. Adequate source documentation to support recorded events;
3. A record retention system that ensures compliance with state and federal requirements;
4. Reports that provide managers with timely and useful information; and
5. Reconciliations performed timely to enable timely detection and correction of errors and irregularities.

Based on our observations, the Agency's accounting system is not providing users with the information they need to carry out their duties. Internal users do not appear to understand or trust the information provided by the accounting system. As a result, program managers do not use the accounting reports provided by budget and finance. Instead program managers often maintain their own books, usually in a federal reporting format, and completely ignore the books maintained by budget and finance.

The situation described above is most evident in facilities management (FMO). FMO is responsible for construction activities at all Agency facilities. Most FMO employees are employees of the federal government who work in the Agency's headquarters. The Agency's procurement department is also involved with construction projects. We noted that information necessary to ensure proper accountability is not always communicated between FMO, budget and finance, and procurement. For example, we noted open federal grants on the Agency's books which were considered closed by the FMO. We were told that the Agency had not closed them because the accounting records reported negative or positive cash balances in the federal grant accounts.

We also noted that the Agency does not prepare timely account reconciliations. In addition, adjustments to record reconciling differences noted during the reconciliation process are not made. As a result, errors which may have a material effect on the accounting records of the Agency and/or State (i.e., STARS) are not detected timely and may go uncorrected. For example, we noted that the Agency did not use the correct project and phase code when it processed certain federal grant transactions. These errors also affect the State Treasurer's Office (STO), because the STO uses information from STARS to monitor compliance with the Cash Management Improvement Act.

Monitoring

Management monitors internal controls to ensure that the controls are effective and operating as intended. Effective monitoring procedures include independent checks by managers and supervisors, as well as an active internal audit presence. In fiscal year 1998, the Agency hired a resources manager who was responsible for budget and finance, internal review, and procurement. This employee was given additional responsibilities, which prevented her from effectively managing these three areas. In addition turnover in key accounting personnel exacerbated the condition.

We were told that the internal review function was not staffed until January 1999 when one of the two positions was filled internally. Therefore, periodic site reviews of the Guard units have not been performed even though these units have been given more administrative responsibilities during this same period. We are uncertain whether the internal review employee is performing routine quality reviews (i.e., internal audits) of the Agency or is working on special projects. However, if the internal review department is to perform an internal audit function it must be independent of the resources manager and should therefore report to upper level management (e.g., the Adjutant General).

In the State Auditor's Report for fiscal year 1999 we stated that the Agency's accounting personnel told us that they had updated the Agency's STARS Manual and were training employees to comply with the policies and procedures included in the STARS Manual. Furthermore, we were told that the internal review employee began periodic site reviews of the Guard units in September 1999 and that this employee reports directly to the Chief of Staff of State Operations. In our review of the Agency's operations for fiscal year 2000, we determined that the internal review employee had in fact performed periodic reviews of Guard units. We also noted that this employee has been assigned additional accounting tasks which has limited her internal review role. If the Agency intends for the internal review employee to act as an internal auditor, she should be independent of the budget and finance department and report to upper level management.

In May 2000, the Agency hired a Director of Fiscal Systems with significant State agency experience to implement corrective action for existing deficiencies noted in prior State Auditor's Reports. Because this new employee began work in the latter half of the fiscal year,

very little corrective action was made in fiscal year 2000. We were told that the accounting department was reorganized in fiscal year 2001 and that the Director of Fiscal Systems has been assigned to supervise the day-to-day accounting operations. These additional duties would inevitably cause a delay in the implementation of corrective action for many of the deficiencies on which we have reported. However, we determined that some improvement was made in fiscal year 2000 regarding internal controls. For example, the Agency has improved its use and reliance on the accounting system and required its supervisors to review the work of subordinates.

During the fiscal year 2000 engagement, we identified three instances in which Agency employees bypassed control procedures (see Expenditures and Payroll comments). We determined that upper management did not become aware of the situations until months after they had occurred. Based on our inquiries, the Agency has no written policy that encourages employees to report suspected improprieties upstream to management. Strong internal controls require effective communication between management and its staff.

Recommendations

We again recommend that the Agency thoroughly review and evaluate its system of internal controls over the entire Agency. It should begin with the control environment as it sets the tone for the entire organization and is the foundation for all other components of internal control. In order to correct the numerous weaknesses and errors detailed in the following comments and maintain the improvements in the future, the Agency must address its control activities (policies and procedures) to ensure that the Agency is accountable to the State and its grantors. Beyond the organization-wide controls, the Agency must devote significant attention to the information and communication component of internal controls. The Agency must improve its reporting to its internal users, the State, and its grantors. Furthermore, the Agency should develop written procedures for encouraging employees to communicate

important information to upper management (including suspected improprieties). Finally, we recommend that the Agency improve its monitoring component of internal control to ensure quality within the Agency.

DEPOSITS

We tested a sample of 50 deposits and noted the following deficiencies:

1. Supporting documentation (cash receipt, date stamp, and/or validated deposit slip) was missing for 24 deposits (the majority were deposits of armory rental receipts). As a result, we could not determine if the deposits were deposited timely in accordance with State law and Adjutant General regulations or were recorded in the correct fiscal year.
2. One deposit of armory rental receipts was not deposited timely in accordance with State law and Adjutant General regulations.

Similar deficiencies were noted in the State Auditor's Reports for fiscal years 1997 through 1999.

Proviso 72.1 of the fiscal year 2000 Appropriation Act requires that receipts be remitted to the State Treasurer at least once each week, when practical. Also, Adjutant General Regulation (AGR) 37-2, Paragraph 1-13.c.(4) requires all funds received to be deposited by Tuesday of each week. Furthermore, sound accounting practice requires that supporting documentation including appropriate information (e.g. - document number, amount, account, subfund and fiscal year) be properly maintained to document proper recording of revenues.

We again recommend that the Agency develop and implement control procedures to strengthen internal controls over cash receipts and revenues that will ensure that receipts are deposited in accordance with sound accounting practice and with the Agency's policies and State laws, rules and regulations. Also, the Agency should establish procedures to ensure that supporting documentation is properly maintained and safeguarded.

EXPENDITURES

Procurement Code

Our sample of 25 cash disbursements included five vouchers for goods or services that cost less than \$1,500, which the Agency did not annotate that the “price is fair and reasonable” as required by the South Carolina Consolidated Procurement Code (the Code), Section 11-35-1550.2(a).

Similar comments were included in the State Auditor’s report for fiscal years 1997 through 1999.

Expenditure Cutoff

During the test of the Accounts Payable Closing Package, we noted that the Agency paid \$3,408,158 with fiscal year 2001 appropriations for goods and services that were received in fiscal year 2000. We were told by accounting personnel that the Agency did not have policies and procedures to ensure that vendor invoices are paid in the proper fiscal year. Proviso 72.3 of the Fiscal Year 1999-2000 Appropriation Act states, “Subject to the terms and conditions of this act, the sums of money set forth in this Part, if so much is necessary, are appropriated ... to meet the ordinary expenses of the state government for Fiscal Year 1999-2000, and for other purposes specifically designated.”

Similar comments were included in the State Auditor’s report for fiscal years ended 1997 through 1999.

We recommend that the Agency review its internal control policies and procedures over disbursements and expenditures to ensure that they are adequate in design, properly implemented, and operating effectively. These policies and procedures should also ensure compliance with state and federal laws, rules, and regulations. We also recommend the accounting department develop and implement procedures to ensure that the Agency pays for goods/services in the fiscal year in which they are received. Such procedures should include

contacting vendors at fiscal year end for invoices for goods/services received through June 30 and notifying other Agency departments to promptly forward vendor invoices to the accounting department.

Purchasing Procedures

Nine of the 25 voucher packages tested were not stamped documenting that clerical accuracy was checked. We were told that the agency did not enforce the policy of stamping invoices for direct expenditures (e.g., monthly utilities). Six of the nine vouchers were for direct expenditures, two were for travel reimbursements, and one was for an armory reimbursement.

While testing a correcting journal entry for one of the Agency's purchases, we found that the related purchase order was dated two weeks after the invoice date because an accounting supervisor overrode the Agency's procedures requiring a purchase order to be completed prior to making a purchase.

Recommendations

We recommend that the Agency review its internal control policies and procedures over disbursements and expenditures to ensure that they are adequate in design, properly implemented, and operating effectively. These policies and procedures should also ensure compliance with State and federal laws, rules, and regulations and Agency procedures.

RECONCILIATIONS

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

Agencies are required to perform cash, revenues, expenditures, and CSA467 report (federal programs) reconciliations between their books and those of the State Comptroller General who maintains the State's books (STARS). For all four types of monthly reconciliations for both fiscal years 1998 and 1997, we noted that the Agency did not adequately document or explain variances between STARS and the Agency's books. The Agency had a temporary employee preparing the reconciliations much of this time. He primarily identified differences (in total) as opposed to identifying reconciling items. The Agency did not use the reconciliation process as a means to

identify and correct errors. We requested explanations for reconciling items as the engagement progressed and as we completed fiscal year 1997 fieldwork in April 1998. The Agency stated that it would provide us this information within a few weeks. When we returned in September 1998, to begin the fiscal year 1998 engagement, the Agency still could not provide us with the 1997 information and it never provided us with explanations for fiscal year 1998 reconciling items. We could not determine why the variances existed between STARS and the Agency's books or which books are correct. The Agency did not place an emphasis on controls over reconciliations and therefore it allowed errors to go undetected and uncorrected.

The temporary employee responsible for preparing the reconciliations terminated in December 1998. In our opinion the Agency is not using the reconciliation process to identify and correct errors.

Also for fiscal year 1997 reconciliations, we noted the following control weaknesses:

1. Several expenditure reconciliations were not signed and dated by the reviewer and two were not signed and dated by the preparer or reviewer.
2. Several revenue reconciliations were not signed and dated by the reviewer. Two monthly reconciliations were missing.
3. The cash and CSA467 report reconciliations for the months of July through April were not signed and dated by the preparer or reviewer.

For the fiscal year 1998 reconciliations, we noted the following control weaknesses:

1. Expenditure reconciliations were not dated by the preparer or reviewer.
2. Several revenue reconciliations were not dated by the reviewer. One was not signed or dated by the reviewer.
3. Cash reconciliations were not signed and dated by the preparer or reviewer. They were not prepared on a timely basis. Reconciliations for the months of July through January were dated May 1; February on May 11; March and April reconciliations on May 22; and May, June, and fiscal month 13 in September 1998.

The following comment was included in the State Auditor's report on the Agency for fiscal year 1999.

We requested reconciliations for fiscal year 1999 and were told by accounting personnel that they only reconciled July 1998 through November 1998 but could not locate these reconciliations. We compared year-end revenues and expenditures between the Agency's books and STARS and noted numerous variances that the agency was unable to explain. We also performed analytical reviews (compared recorded revenues and expenditures with those of the prior year and compared the percentage distribution of recorded payroll expenditures by fund source with the percentage distribution of fringe benefits by fund source) to determine the reasonableness of recorded amounts. Again the Agency was unable to explain significant variances because it does not know whether its books, STARS, or either are correct.

Accounting personnel told us that they still had not performed all the reconciliations for fiscal year 2000 at the time of our engagement. Because the Agency failed to perform the required reconciliations, we were unable to rely on data recorded in the Agency's books and in STARS for performing our analytical review procedures for revenues, expenditures, and distribution of fringe benefits.

On its fiscal year 2000 operating lease closing package, the Agency reported a variance of \$864,875 between its recorded operating lease expenditures and the lease expenditures recorded on STARS. The difference could have been corrected had the Agency performed the reconciliations as required.

Section 2.1.7.20 C. of the STARS Manual requires that all agencies perform regular monthly reconciliations between their accounting records and STARS balances shown on STARS reports. These reconciliations must be performed at least monthly on a timely basis, be documented in writing in an easily understandable format with all supporting working papers maintained for audit purposes, be signed and dated by the preparer, and be reviewed and approved in writing by an appropriate agency official other than the preparer. Errors discovered through the reconciliation process must be promptly corrected in the agency's accounting records and/or in STARS as appropriate.

We again recommend the Agency develop and implement procedures to ensure that monthly reconciliations are promptly prepared and timely reviewed in accordance with State policy. Any reconciling items between the Agency's accounting records and STARS should be adequately explained and corrected in a timely manner.

ACCOUNTING TRANSACTIONS

Journal Entries

We randomly selected a sample of 15 journal entries to test and found the following exceptions:

1. One journal entry could not be located by Agency personnel.
2. One journal entry did not agree with supporting documentation.
3. Two journal entries did not contain sufficient supporting documentation for the entry being made.

Operating Transfers

We tested all five of the Agency's operating transfers and noted the following exceptions:

1. One transfer document contained many supporting documents with conflicting financial amounts.
2. Two transfer documents did not contain sufficient supporting documentation.

Appropriation Transfers

The Agency was unable to provide us with supporting documentation for all of its interagency appropriation transfers, totaling \$2,546,429.

Because the supporting documentation for these transactions was not properly prepared or maintained, we were unable to determine whether these transactions were properly recorded.

For internal controls to be effective, control procedures must be designed and operating to ensure the propriety and accuracy of recorded transactions and to prevent errors and irregularities. These controls include proper preparation and maintenance of adequate documentation.

Recommendations

We recommend that the Agency ensure that its accounting transactions are properly supported by adequate documentation and maintained for easy retrieval.

CLOSING PACKAGES

All Closing Packages

The State Comptroller General's Office obtains GAAP (generally accepted accounting principles) data from agency-prepared closing packages for the State's financial statements. Section 1.8 of the GAAP Closing Procedures Manual (GAAP Manual) states that each agency is responsible for submitting accurate and complete closing package forms that are completed in accordance with instructions and further states that, "The accuracy of closing package data is extremely important." Section 1.9 states, "Agencies should keep working papers to support each amount they enter on each closing package form." In addition, the GAAP Manual recommends an effective review of each closing package and the underlying working papers to minimize closing package errors and omissions. To assist each agency in performing effective reviews, the State Comptroller General's Office requires a reviewer checklist to be completed for each closing package submitted.

Operating Leases

The Agency failed to complete lease registers for five leases and omitted information pertaining to these leases from the Operating Leases Summary Form. Also, the agency did not split charges for copier leases between the lease payment object codes and the executory costs object codes. The Agency stated that they overlooked the journal entry to correct the object codes at year-end.

Based on these errors the Agency understated future net minimum lease payments and executory costs and also did not comply with Section 3.19 of the GAAP Manual. GAAP require the agency to report future net minimum lease payments and executory costs for all noncancelable operating leases with initial or remaining terms at June 30 exceeding one year. Section 3.19 of the GAAP Manual requires the agency to complete a lease register for all leases in accordance with the State Treasurer's Lease Reporting Package except as exempted for 1999 State contract leases. Section 3.19 also requires the agency to split costs between lease payments and executory costs.

We recommend that the Agency prepare a lease register for each lease at inception (except for those under the 1999 State contract as exempted) in order to determine proper lease classification for preparation of the operating leases closing package. We also recommend that the Agency establish procedures for ensuring that costs are split between lease payments and executory costs as required.

Fixed Assets

Agency personnel could not provide adequate support on its fixed assets closing package for amounts reported as net corrections to prior year balances, retirements to construction in progress, and noncapitalized permanent improvement project expenditures. Also, the Agency reported no outstanding construction commitments at June 30, 2000, although it has several ongoing projects and it reported new contract retentions in fiscal year 1999 but no contract retentions paid in fiscal year 2000. A similar comment was included in the State Auditor's reports for fiscal years 1997 through 1999.

The Agency violated Section 3.7 of the GAAP Manual which states that the reporting agency should compute the outstanding commitment for each project in progress at June 30 as follows:

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

The Agency should then add together the outstanding amounts for all projects in progress at June 30.

The Agency also did not comply with Section 3.8 of the GAAP Manual which requires the agency to maintain full documentation for fixed assets additions, retirements, reclassifications, corrections of prior year balances, and intra-state transfers.

Recommendations

We recommend that the Agency prepare lease registers (when required) at the inception of its leases and report all leases in accordance with the GAAP Manual instructions. We also recommend that the Agency review its capital projects for information regarding the proper reporting of construction commitments and retention at year-end. Furthermore, we recommend that the Agency 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. These controls should cover any information processed through STARS, closing packages, and the Agency's accounting records.

DEFERRED REVENUES

The following comment was included in the State Auditor's Report on the Agency for fiscal years 1998 and 1997 and repeated in fiscal year 1999.

For fiscal year 1996, we noted that the Agency did not record revenues received but not earned until future periods as deferred revenues on its or the State's books as required by Section 3.2.2.1 of the STARS Manual. In fiscal year 1997, the Agency recorded deferred revenue in the State's books, but it recorded the transaction as ordinary revenue in its books. To agree the Agency's books to the State's books, we had to add the revenue and deferred revenue accounts on the State's books and agree the sum of those accounts to the revenue accounts on the Agency's books.

In fiscal year 1998, the Agency reversed the June 30, 1997 deferred revenues on the State's books. It recorded current deferrals in a separate revenue account on its books and in the deferred revenue account on the State's books. The Agency's accounting system allows for liability accounts, but it has not used the system to properly account for these transactions in accordance with generally accepted accounting principles (GAAP) or the State's instructions.

We were told by accounting personnel that the Agency is still recording revenues received but not earned until future periods as ordinary revenue in its books instead of in a liability account.

We continue to recommend that the Agency fully utilize its accounting system and properly account for deferred revenue. We also recommend that the Agency train its employees in the preparation and review of receipts and deposits to ensure proper procedures and accurate coding in accordance with both the State's accounting practices and GAAP.

PETTY CASH CHECKING ACCOUNTS

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

The Agency maintains approximately 80 armory units across the State. It receives a line-item State general fund appropriation of approximately \$1.3 million to fund these armories. The Agency expends a small portion directly from that line item. The remainder is recorded as an expenditure from the State General Fund and as a revenue to the 3174 earmarked subfund. Each unit across the State opens a bank account in its

name and operates it as a petty cash checking account. The units periodically request reimbursement from the 3174 subfund to replenish their bank accounts.

The supporting document provided by the Agency for the cash and investments closing package listed the imprest amount for each unit. For fiscal year 1997, all accounts had a \$500 amount. This was the agency-authorized maximum amount for these accounts. For 1998, many of the accounts still have a \$500 amount, but we noted 21 accounts had balances greater than \$500, including a maintenance unit in Orangeburg that had a \$3,700 balance. The Agency violated its own policy and State law by authorizing amounts greater than \$500 and not obtaining the State Auditor's Office approval to increase these accounts.

Adjutant General Regulation 37-2, Paragraph 1-13.a. states, "Authorization to open a bank checking account must be requested in writing to TAG-DSO and approved by the South Carolina State Treasurer's Office and State Auditor's Office..." and Paragraph 1-13.b. states "Each Armory Fund Custodian shall be allocated \$500." The only exception given for a higher amount is for bank accounts that impose banking fees for accounts with a minimum \$200 balance. State law requires agencies to obtain State Treasurer approval for bank accounts and State Auditor approval for petty cash accounts.

The following comment was included in the State Auditor's report for fiscal year 1999.

For fiscal year 1999, we again noted that 21 accounts had balances greater than \$500. We were told by accounting personnel that in fiscal year 2000 those armories with balances greater than \$500 were given permission to do so by the Agency. However, the Agency did not obtain approval from the State Auditor's Office to increase the petty cash accounts above \$500.

For fiscal year 2000, we noted that 27 accounts had balances greater than \$500. Accounting personnel told us that the Agency still has not obtained the approval from the State Auditor's Office to increase the petty cash accounts above \$500.

We recommend the Agency implement policies and procedures to ensure that prior approval is obtained from the State Auditor for increases in the petty cash checking accounts.

PAYROLL

Initial Pay

During our test of employee additions, we noted seven instances in which employees were not paid in a timely manner. Late payments ranged from several weeks to more than one year after starting work. The employees were not paid timely because required payroll documentation (e.g., employee leave and attendance records, and personnel/payroll action requests) was not submitted by the armory supervisors to the payroll department at headquarters in a timely manner. The Agency violated Section 4.2.22.1 of the Comptroller General's Policies and Procedures Manual (STARS Manual), which requires vouchers to be delivered to the Comptroller General within 30 days from the receipt of services. Also, two of the payments were made from fiscal year 2001 appropriations for services performed in fiscal year 2000 which violated Proviso 72.3 of the FY01 Appropriation Act which states that "... the sums of money set forth ... are appropriated from the general fund of the state ... and other applicable funds to meet the ordinary expenses of the state government for the Fiscal Year 2000 – 2001..."

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

Termination Pay

Four of the 25 termination pay transactions tested contained errors that resulted in a total overpayment to two employees of \$283 and total underpayment to two employees of \$158.

The overpayments occurred because the Agency paid the employees for more days than they actually worked during their final pay period. One of the underpayments occurred because the Agency did not take into account the employee's general pay increase of 2.5%

when calculating the employee's final pay. The other underpayment occurred because the Agency calculated the employee's hourly rate using 2,080 hours per year when the employee's salary was based on 1,950 hours per year.

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

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

Pay Authorizations

During the fiscal year 2000 engagement, we identified two instances in which control procedures regarding pay authorizations were bypassed. The first instance occurred when the Agency procured the services of several federal military personnel to develop a new software program for processing State active duty payroll. In order to pay these individuals through the Agency's payroll system, the Resource Manager asked her subordinate (a payroll accountant) to add the individuals to the payroll without completing Personnel/Payroll Action Request forms and obtaining appropriate approvals. At various times, the Resource Manager asked the payroll accountant to pay these temporary employees certain amounts but provided no approved time and attendance records to support the payments. During this time the Resource Manager terminated employment with the Agency and the Director of Budget and Finance (Director) who reported to the Resource Manager asked the payroll accountant to continue

processing payments for these individuals. The second instance occurred when the Agency decided to change the funding source for several employees, from federal to state. The Director asked the payroll accountant to make the changes without the use of approved Personnel/Payroll Action Request forms. One of the fund sources changed was that of the Director. The Agency has investigated these situations with the assistance of outside counsel to determine the extent of the problems and to take necessary corrective action. As of the date of this report, the Director was transferred from the budget and finance area. The Agency has counseled the payroll accountant who believed that proper procedures were not being followed but was doing what her supervisor requested.

Agency procedures require the use of Personnel/Payroll Action Request forms for all changes in personnel/pay status including adding employees to the payroll and changing fund source. These forms are to be initiated/approved by the appropriate program director and approved by the directors of human resources, resource management and the Adjutant General or Deputy Adjutant General. Agency procedures also require temporary employees to document time worked on timesheets that are to be approved by their supervisors. Furthermore, strong internal controls required the Agency to have a policy that encourages employees to report suspected improprieties to upper management.

Recommendations

We recommend that the Agency train employees on the proper procedures for authorizing and processing payroll transactions. The Agency should prepare a written policy that provides a clear understanding with employees about the types of problems that should be reported upstream to management, spells out the appropriate channels for communicating the information, and encourages employees to report suspected improprieties to management.

EMPLOYEE BLANKET BOND

The Agency did not have an employee blanket bond for fiscal year 2000. The term for the previous bond expired in April 1998 and we were told by Agency personnel that the Agency has decided not to renew the coverage.

Section 25-1-330 of the 1976 Code of Laws states “The Adjutant General shall obtain and pay for, from the military fund, surety company bonds running to the State, in such amounts as prescribed by the Adjutant General, covering all officers of the National Guard of South Carolina responsible to the State for money or military property . . .” Section 1-11-180 of the 1976 Code of Laws requires blanket bonds to be approved by the Attorney General and the Budget and Control Board (the Budget and Control Board has assigned its responsibility to the State Auditor’s Office).

We recommend that a new blanket bond covering employees responsible for money or military property be purchased immediately, and that safeguards be implemented to keep the insurance from lapsing in the future. The Agency should also obtain the required approvals.

SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE

The State Auditor’s Office prepares the State’s schedule of expenditures of federal awards (SEFA) from agency-prepared schedules of federal financial assistance (SFFA). The State Auditor’s Office issues instructions to each agency for proper completion of the SFFA. The SEFA is the primary financial statement audited in the Statewide Single Audit. We tested the Agency’s SFFA for fiscal year 2000 during our Statewide Single Audit and have summarized those findings below:

1. For one fund, the project phase code reported on the SFFA did not agree to the project phase code on the Comptroller’s General’s CSA 467 Report.
2. For four funds, the CFDA numbers reported on the SFFA were incorrect.
3. For one fund, the beginning balance as reported on both the SFFA and the general ledger was incorrect.

4. Total cash, revenues, and expenditures do not agree to the amounts reported on the Comptroller General's Reports.
5. In our prior year finding, we noted that expenditures of \$381,422 for two projects funded from the 1998 MCA funds were reported on the 1999 SFFA as 1999 MCA expenditures. Per review of the current year SFFA, the Agency has not corrected this exception.

Similar findings were noted in the State Auditor's Reports for fiscal years 1997 through 1999.

We again recommend the Agency establish policies and procedures to ensure that the SFFA is accurate; complete; prepared and reviewed by trained personnel; and supported by its accounting system and grant files. The Agency should carefully read and follow instructions from the State Auditor's Office.

PUBLIC ASSISTANCE

Pass-Through Funds

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

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

The Agency established two subfunds to account for federal grant pass-through funds received from the Federal Emergency Management Agency (FEMA). Subfund 5544 was established in fiscal year 1998 for hurricane relief and subfund 5903 was established several years ago for flood relief. The Agency recorded funds drawn from FEMA as credits to federal grant revenues and pass-through funds as debits to federal grant revenues. We noted several errors in the Agency's use of these subfunds. First of all, these subfunds translate to a governmental GAAP fund code in the State's GAAP-basis accounting system instead of to an agency GAAP fund code. Secondly, if the Agency had used these subfunds as it intended, federal grant revenues would have netted to zero for each subfund at fiscal year end because the Agency debited revenues instead of expenditures when recording the transfer to another State agency. This did not occur because of a subfund recording error. As we reported in the State Auditor's Report for fiscal years 1998 and 1997, the Agency recorded revenue received in the proper subfund; however, it transferred to another State agency approximately \$49,000 out of subfund 5544 instead of 5903, leaving subfund 5544 with a deficit revenue balance of approximately \$49,000. This error and approximately \$14,000 in ending cash balance created

an ending balance of approximately \$63,000 in subfund 5903 federal grant revenues. In fiscal year 1999, subfund 5903 had no activity and therefore maintained its ending balance of approximately \$63,000. However, subfund 5544 reported revenue of approximately \$42,000 and a revenue transfer of approximately \$66,000 resulting in a deficit revenue balance of approximately \$73,000.

For fiscal year 2000, we found that the Agency had no activity in these subfunds and therefore no change in the reported balances.

Reimbursed Funds

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

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

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

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

Section 2-65-70(A) of the 1976 South Carolina Code of Laws, as amended, states in part, "All indirect cost recoveries must be credited to the general fund of the State, with the exception of recoveries from research and student aid grants and contracts." Code Section 11-9-125 states, "Federal and other funds must be expended before funds appropriated from the general fund of the State, to the extent possible, and any excess balances in accounts resulting from matching fund programs must be remitted to the general fund of the State. Federal or other funds generated by the expenditure of state funds, including refunds from prior year general fund expenditures, must be remitted to the general fund of the State if there is no federal or state requirement governing the specific use of the funds ..."

Recommendations

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

PERMANENT IMPROVEMENT PROJECT ACCOUNTING

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

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

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

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

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

Section 2-47-35 of the 1976 South Carolina Code of Laws, as amended, specifies that no project authorized for any capital improvement bond funding can be implemented until funds are made available and describes an authorization and approval process for scope, budget, and funding changes. Part I, Chapter 4 of the State's Manual for Planning and Execution of State Permanent Improvements (SPIRS Manual) states that when an agency requests transferring funds between projects, it should ensure that sufficient funds remain in the project from which the funds are to be transferred. However, the procedures here relate to transferring balances of projects nearing or at completion instead of transfers from new projects to complete old projects. Both

the Code and the SPIRS Manual specify responsibilities of the Budget and Control Board, Joint Bond Review Committee, and the General Assembly. However, the Agency did not inform oversight agencies or seek approval for its actions.

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

We recommend that the Agency cease funding the completion of one project with a new project's funding and correct the errors which have already occurred. The Agency should charge expenditures to and draw funds from the proper project and also inform and seek necessary approval for all transfers in funding for its SPIRS projects. Finally, we recommend that the Agency correct its and the State's books for projects over budget by funding source, for transactions made without proper authority and for use of improper accounts.

DATA TRANSLATION TO THE STATE

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

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

All federal grants and permanent improvement projects are assigned project numbers, which are four digit numbers. Recurring grants awarded by grant year maintain the same project number but retain their separate identity through the use of phase codes, which are two digit numbers that follow the project numbers. Together these six digit project/phase code numbers comprise

the State's D38 table. When permanent improvement projects are funded by federal grants, the State uses a process to interrelate the grant and permanent improvement project/phase codes. This process is described in the STARS Manual in Section 2.1.2.50. For fiscal years 1998 and 1997, the Agency has not submitted accurate information in sufficient detail to the State to ensure that the project/phase codes are used properly. It has not interrelated its grants and permanent improvements as required by the State. Therefore, because the Comptroller General relied on this data, the State's financial statements are incorrect as they relate to the Agency. We could not determine the extent of the inaccuracies; however, we informed the auditors of the State's financial statements of the problem and also pointed out the significant size of the Agency.

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

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

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

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

Accounting personnel told us that the conditions described above still existed during fiscal year 2000. The Agency anticipates it will begin reconciling to the CSA467 report during fiscal year 2002.

We again recommend that the Agency train its employees in the proper accounting of transactions and balances in its accounting system (SABAR), STARS, and GAAP-basis data provided to the Comptroller General. Also, we recommend that the Agency implement policies and procedures which ensure that all accounting data will be accurate, timely, and in compliance with all State and federal laws, rules, and regulations as well as with GAAP. The Agency should review the project/phase codes and CFDA numbers for each active grant and permanent improvement project and should make all the corrections needed. It should contact the Comptroller General and State Treasurer to determine what action is needed to correct errors that have already occurred.

SECTION B - STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountant's Comments section of the State Auditor's Report on the South Carolina Office of the Adjutant General for the fiscal year ended June 30, 1999, and dated June 8, 2000. We determined that the Agency has not taken adequate corrective action on the findings listed below which we have repeated in Section A of this report.

1999 Comment Title

INTERNAL CONTROL

REVENUES

Deposits and Supporting Documentation

EXPENDITURES

RECONCILIATIONS

ACCOUNTING TRANSACTIONS

CLOSING PACKAGES

All Closing Packages

Operating Lease

Fixed Assets

DEFERRED REVENUES

PETTY CASH CHECKING ACCOUNTS

SCHEDULE OF FEDERAL FINANCIAL

ASSISTANCE

PUBLIC ASSISTANCE

PERMANENT IMPROVEMENT

PROJECT ACCOUNTING

DATA TRANSLATION TO THE STATE

2000 Comment Title

INTERNAL CONTROL

DEPOSITS

EXPENDITURES

RECONCILIATIONS

ACCOUNTING TRANSACTIONS

CLOSING PACKAGES

All Closing Packages

Operating Leases

Fixed Assets

DEFERRED REVENUES

PETTY CASH CHECKING ACCOUNTS

SCHEDULE OF FEDERAL FINANCIAL

ASSISTANCE

PUBLIC ASSISTANCE

PERMANENT IMPROVEMENT

PROJECT ACCOUNTING

DATA TRANSLATION TO THE STATE

MANAGEMENT'S RESPONSE

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

January 7, 2002

Mr. Thomas L. Wagner, Jr., CPA
State Auditor
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, SC 29201

Dear Mr. Wagner:

My staff has completed our review of the agreed-upon procedures report for the year ending June 30, 2000 and authorizes the release of this report. I am enclosing our response to your comments, which will be added to your report.

We have made many improvements and will continue to implement your recommendations. It is our goal to have all recommendations implemented by the end of fiscal year 2002.

Sincerely,

A handwritten signature in black ink, appearing to read "St Stanhope S. Spears".

Stanhope S. Spears
Major General, SCARNG
The Adjutant General

Internal Control

We have developed an internal control program and are working to ensure that it is implemented and that controls in all areas are improved. In May 2000, we hired a certified public accountant who has considerable state experience. We are working to increase overall state knowledge through internal and external training and by hiring new employees with state experience. We are focusing our hiring efforts on permanent (not temporary) employees with a focus on long-term solutions as well as some short-term, highly experienced employees with a short-term focus of catching up areas that have fallen behind. To improve compliance with laws, rules, and regulations, we have obtained current reference materials, such as the STARS Manual. We are taking steps to correct the findings noted in the last several years' audit reports. However, it will take time to correct some of these weaknesses that existed for several years.

In fiscal year 2000, we revised our account structure to maximize the use of all components of an account number: department, fund, and object. By doing so, we can now report in a manner usable by both the federal and state government. This has eliminated the need for separate records to be maintained for federal reporting purposes and has also increased the working relationship between budget and finance and the Agency's program managers.

We have worked with the United States Property and Fiscal Officer (USPFO) to zero old grants from 1997 through 1999 on our books. We have been able to receive amounts still due the Agency and return amounts owed to the federal government. We have not completed this task, but we have made significant progress.

Bringing the reconciliation process up to date is our biggest challenge. We expect that this will be the longest process in our corrective action plan. We have made significant improvements in this process and corrected many of our prior years' errors. By fiscal year 2001 end, we had reconciled the State General Fund.

In February 2001, we appointed our CPA to be over all of resource management. The division is being reorganized to cover all aspects of the workload and to improve internal controls.

We are continuing to improve the quality assurance (referenced in your report as internal review) process. In federal fiscal year 2001, we transferred an employee with a bachelors degree in accounting to the quality assurance area. She is developing an annual audit plan and will report to a newly formed audit committee that is chaired by the Adjutant General.

Deposits

Although we have improved our controls over revenues including the deposit process, we have not eliminated our problems with armory deposits. Military employees who turn over frequently do these deposits. Therefore, we must continually train new people. We

have reissued guidance to the armories and other receipting locations regarding the required controls and procedures. Also, our quality assurance and armory operations coordinator offer one-on-one training and group training.

Expenditures

Procurement Code. Our procedure is to record that the price is fair and reasonable on the purchase requisition because this is the place in the process where this determination is made. (Because of the decentralization of the procurement and accounts payable process, the purchaser usually will not receive the invoice. The requisitioner and the appropriate approvers are the ones who should make this determination not the accounts payable clerks.) We have determined that this procedure would not cover direct payments, i.e., vouchers paid without a purchase order. Beginning in fiscal year 2001 for these vouchers, we will ensure that the invoices are evaluated and noted as "fair and reasonable".

Expenditure Cutoff. We significantly improved in this area at the end of fiscal year 2001. Both accounts payable and procurement worked to ensure that open purchase orders were closed as either paid or cancelled and that all voucher information (invoice, receiving report, etc.) was received timely to permit payment before the cutoff of month thirteen. We corresponded with all program areas to remind them of the cutoff requirements and to encourage their support.

Purchasing Procedures. Most of these exceptions were limited to one type of expenditure, which we will address in fiscal year 2002. We will ensure that the accounts payable team leader reemphasizes the importance of this control.

Reconciliations

As previously stated, the reconciliation process is our biggest challenge. We reconciled some old accounts in fiscal year 2001 and completely reconciled the State General Fund for the year. However, we still have many past and current reconciliations to do. Because we did not properly prepare reconciliations and numerous differences exist between SABAR and STARS, we are experiencing a long, difficult process to correct the errors and bring the reconciliations up to date. We are trying to identify a temporary employee familiar with the state system and reconciliation experience to prepare the older reconciliations. Beginning in December 2001, we have reorganized such that the accounts payable team leader will work approximately half-time on current year reconciliations.

Accounting Transactions

In December 2001, we reassigned the responsibility for approving journal entries, operating transfers and appropriation transfers. We are implementing controls to ensure that the documents have adequate supporting documentation and are properly filed and maintained.

Closing Packages

We made significant improvements in the closing packages prepared for fiscal year 2001. Lease closing packages need improvement, as we did not have proper source data available to prepare these packages. Like many State agencies, we continue to receive conflicting information from the Office of Comptroller General that exacerbates the problem.

The Military Department of South Carolina has a complex fixed assets structure. Some assets are purchased and owned by the military, some are purchased and owned by the (State) Agency, and some are a combination. We have determined that many of the capital projects done via the (State) Agency will not be assets of the Agency. (Such is the case with capital projects built on 100% federal property at McEntire and McCrady.) Therefore, we are seeking guidance from the Comptroller General as to the proper reporting for such projects and assets. We believe that GASB 34 and its implementation guides may address and clarify these issues.

Deferred Revenues

The Agency's deferred revenues are minimal, mainly for armory rental deposits collected in advance. We will include this requirement in budget and finance's policies and procedures manual and ensure that the revenue accountant captures this information at the end of fiscal year 2002.

Petty Cash Checking Accounts

Currently, each of the approximately 85 units has a petty cash bank account. The Agency revised Adjutant General Regulation 37-4 to require that the unit maintenance funds be maintained at the battalion level with each unit in a battalion receiving \$500 once per year. Due to significant controversy and conflict, this portion of AGR 37-4 has not been implemented. Armory operations suffer significant budget woes due to budget cuts and increased utility costs. There are few transactions flowing through these accounts as most of the available funds are needed to cover utilities. However, the politics between military and state do not allow us to close these accounts at the present time. We are continuing to address this issue and resolve it to the mutual satisfaction of all parties. As we determine which accounts to maintain and which to close, we intend to obtain the proper internal and external approvals for the remaining accounts. Also, we intend to audit the accounts as we close them.

Payroll

Initial Pay. We have been unable to solve our timing problems with armory sitters who intermittently work armory rentals at a rate of \$10 per hour. Either the sitter or the armory supervisor does not timely submit the paperwork to notify the payroll department that the sitter has worked or is authorized to work. Centrally, the Agency is unaware that

a sitter has worked if the sitter does not submit a timesheet. However, the sitters are promptly paid when the paperwork is received.

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

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

Pay Authorizations. Both the Resource Manager and the Director of Budget and Finance terminated employment with this Agency. The Agency does not support the decisions these two employees made. Based on internal investigations with the help of outside legal counsel, the Agency determined that it received a reasonable product for a reasonable price (vendor and payroll expenditures combined). However, the procedures used to obtain the product were not legal or prudent practices. We found no reason to suspect that the military personnel employees in question did not provide a service to the Agency. No action was taken against them, although they were informed that if employed again in the future we would expect them to complete standard timesheets.

We have addressed these issues with our payroll accountant and desire to add a middle level of supervision to the payroll process when the budget will allow for it.

Employee Blanket Bond

In the fall of 2001, the Agency assigned its procurement director as risk manager for the Agency. This assignment includes reviewing all risks and insurance policies. We will seek training and coordinate with the various agencies to determine that the Agency is properly covered for all insurable risks.

Schedule of Federal Financial Assistance

The schedule for 2000 was a significant improvement over the 1999 schedule. We improved the controls over the process and do not anticipate significant findings in this area in the future in the future.

Public Assistance

Pass-Through Funds. These old balances will be corrected when the reconciliation are caught up.

Reimbursed Funds. We have expended the \$339,412 and \$5,506 of the \$657,000. The Agency did not realize that administrative costs should be remitted to the State General Fund. Currently, we do not have funds available to remit \$344,918. We will pursue this matter with State authorities to resolve this matter as soon as possible.

Permanent Improvement Project Accounting

Effective July 1, 2000, we reorganized our permanent improvement project accounting. In doing so, procurement's role in this area will be limited solely to approving procurements and issuing purchase orders. Facilities management and budget and finance will handle SPIRS accounting and reporting. We are in the process of developing controls and procedures to ensure that we are in federal and state compliance with permanent improvement project accounting. Also, we are in the process of closing completed SPIRS projects on the SPIRS and STARS systems as well as our SABAR system. We are reviewing CIB balances with the state and federal military construction balances with the USPFO to determine if we have unused funds for permanent improvement projects and what the proper disposition of such funds should be.

Regarding errors in specific projects, we will review and correct errors as appropriate. The Hawk projects (Pickens, Ware Shoals, and Fountain Inn) are in mediation but should be settled soon. As soon as we learn the outcome and finalize the costs, we will ensure that all three projects are properly charged and capitalized.

Data Translation to the State

We have improved our understanding of how STARS and Series Z interrelate to each other and to SABAR. We are working to correct all such deficiencies in SABAR and in the information we provide to STARS and Series Z. We are working the State Treasurer to ensure that we properly comply with cash management. Also, we are working with B&C Board – Budget Division, Grant Services to review the process and ensure the accuracy of our project/phase codes and CFDA number translation.

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