

**SOUTH CAROLINA
STATE DEPARTMENT OF EDUCATION**

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 2006

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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

May 9, 2007

The Honorable Jim Rex
State Superintendent of Education
South Carolina State Department of Education
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the management of the South Carolina State Department of Education (the Department), solely to assist you in evaluating the performance of the Department for the fiscal year ended June 30, 2006, in the areas addressed. The Department'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 in accordance with the agency's policies and procedures and State regulations.
- 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 at the subfund and object code level from sources other than State General Fund appropriations to those of the prior year. We investigated changes in the general, earmarked, restricted and federal funds to ensure that revenue was classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$14,100 – general fund, \$133,900 – earmarked fund, \$1,091,900 – restricted fund, and \$1,062,600 – federal fund) and ± 10 percent.
- We made inquiries of management pertaining to the agency's policies for accountability and security over permits, licenses, and other documents issued for money. We observed agency personnel performing their duties to determine if they understood and followed the described policies.

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

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 in accordance with the agency's policies and procedures and State regulations, were bona fide disbursements of the Department, and were paid in conformity with State laws and regulations; if the acquired goods and/or services were procured in accordance with applicable laws and regulations.
- 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 at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, restricted and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$2,885,300 – general fund, \$140,400 – earmarked fund, \$1,052,100 – restricted fund, and \$1,061,400 – federal fund) and ± 10 percent.

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Object Code Descriptions and Attorney Fees Approval in the Accountant's Comments section 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 processed in accordance with the agency's policies and procedures and State regulations.
- We inspected selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS.

- We inspected payroll transactions for selected new employees and those who terminated employment to determine if the employees were added and/or removed from the payroll in accordance with the agency's policies and procedures, that the employee's first and/or last pay check was properly calculated and that the employee's leave payout was properly calculated in accordance with applicable State law.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement.
- We compared current year payroll expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, restricted and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$2,885,300 – general fund, \$140,400 – earmarked fund, \$1,052,100 – restricted fund, and \$1,061,400 – federal fund) and ± 10 percent.
- We compared the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computed the percentage distribution of recorded fringe benefit expenditures by fund source and compared the computed distribution to the actual distribution of recorded payroll expenditures by fund source. We investigated changes of ± 2 percent to ensure that payroll expenditures were classified properly in the agency's accounting records.

The individual transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Incorrect Pay Period in the Accountant's Comments section of this report.

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

- We inspected 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, the purpose of the transactions was documented and explained, the transactions were properly approved, and were mathematically correct; and the transactions were processed in accordance with the agency's policies and procedures and State regulations.

The individual journal entry transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Appropriation/Cash Transfer Object Codes in the Accountant's Comments section of this report.

5. **General Ledger and Subsidiary Ledgers**

- We inspected selected entries and monthly totals in the subsidiary records of the Department to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and selected entries were processed in accordance with the agency's policies and procedures and State regulations.

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

6. **Reconciliations**

- We obtained all monthly reconciliations prepared by the Department for the year ended June 30, 2006, and inspected selected reconciliations of balances in the Department's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if accounts reconciled. For the selected reconciliations, we determined if they were timely performed and properly documented in accordance with State regulations, recalculated the amounts, agreed the applicable amounts to the Department'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 Department's accounting records and/or in STARS.

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

7. **Appropriation Act**

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

Our finding as a result of these procedures is presented in Proviso 1.89 – Education and Economic Development Act in the Accountant's Comments section of this report.

8. **Closing Packages**

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

Our finding as a result of these procedures is presented in Grant/Contribution Revenues Closing Package in the Accountant's Comments section 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, 2006, prepared by the Department 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 agreed with the supporting workpapers and accounting records.

We found no exceptions as a result of the procedures.

The Honorable Jim Rex
State Superintendent of Education
South Carolina State Department of Education
May 9, 2007

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

This report is intended solely for the information and use of the Governor and of the governing body and management of the South Carolina State Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Richard H. Gilbert, Jr.", written in a cursive style.

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

ACCOUNTANT'S COMMENTS

VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

Management of each State agency is responsible for establishing and maintaining internal controls to ensure compliance with State Laws, Rules or Regulations. The procedures agreed to by the agency require that we plan and perform the engagement to determine whether any violations of State Laws, Rules or Regulations occurred.

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

GRANT/CONTRIBUTION REVENUES CLOSING PACKAGE

The Department's grant receivables and deferred revenues closing package included errors. Some of the calculation errors were the result of spreadsheet formula errors and the others were caused by the exclusion of the receipt of refunds of prior year expenditures. Based on our estimation, the errors caused an understatement of \$19,481 in deferred revenue and a \$19,923 overstatement of grants receivable.

Section 3.3 of the Comptroller General's GAAP Closing Procedures Manual requires an independent review of the closing package. The reviewer's checklist includes questions for the reviewer to verify and reconcile amounts reports.

We recommend that the Department ensure proper calculation of deferred revenue and grants receivable including accurate spreadsheet formulas, inclusion of refunds of prior year expenditures in the calculation, and a thorough review of the calculations.

INCORRECT PAY PERIOD

We found that three of the twenty-five newly hired employees tested were not paid in accordance with the State's pay schedule. One part-time employee who began work on August 25, 2005 did not receive his first paycheck until September 30, 2005. He should have been paid on September 16, 2005. Another employee began work on July 19 and received his first check on September 1. The third employee started on July 22 and received his first check on September 30. These employees should have been paid on August 16, 2005. The employees were not paid in accordance with the State's pay schedule because the employees' timesheets were not submitted timely.

Section 8-11-30 of the 1976 Code of Laws states, “To provide a regular and permanent schedule for payment of employees, the payroll period begins in June 2nd of the prior fiscal year with the first pay period ending on June 16 of the prior fiscal year. The payroll period continues thereafter on a twice monthly schedule as established by the State Budget and Control Board.”

We recommend the Department implement procedures to ensure the timesheets of hourly employees are submitted timely to enable the employee pay to be in accordance with the State’s pay schedule.

OBJECT CODE DESCRIPTIONS

We selected twenty-five receipt transactions and twenty-five disbursement transactions. In one of twenty-five receipt transactions and two of twenty-five disbursement transactions we found that the Department recorded the transactions using incorrect object codes. The Department used object code 1610 (Allocations EIA – South Carolina State University Paraeducator Program) to record an expenditure reimbursement received from a school district. This object code was also used on the two disbursement transactions. These disbursements recorded the transfer of technology initiative funds to school districts. The expenditure transactions also included a charge to object code 1682 (Allocations EIA – Parent Support) for a payment for family literacy (Object Code 1683), a charge to object code 1626 (Allocations EIA – Academic Assistance Act 135) for a payment for Adult Education (Object Code 1640), and a charge to object code 1643 for a payment for middle school initiative (Object Code 1634). Object code 1643 was not included in the Comptroller General’s 2006 STARS manual. A similar exception was noted for a South Carolina Office of First Steps to School Readiness transaction processed by the Department.

Based on our review it appears that the Department has defined several minor object codes for Education Improvement Act (EIA) allocations that do not agree to the STARS definition. Object code definitions used by the Department should agree with those used by the Comptroller General's Office.

We recommend that the Department modify its chart of accounts to ensure that its object code descriptions are consistent with STARS.

APPROPRIATION/CASH TRANSFER OBJECT CODES

Three of twenty-two Appropriation/Cash transfer transactions tested were coded to the wrong object code. Two of the transactions recorded proceeds from the sale of surplus equipment. The Department used object code 7855 (Sale of Works of Art and Historical Treasures - Capitalized) instead of object code 7859 (Sale of Machinery and Equipment – Non-Capitalized). The third transaction recorded the transfer funds to the Governor's School of Science and Math for the Junior Scholars Program. The Department used object code 1663 (Allocations EIA – Other State Agencies) instead of object code 1697 (Allocations EIA – Governor's School for Math and Science).

Sections 2.1.6.10 and 2.1.6.20 of the Comptroller General's Statewide Accounting and Reporting (STARS) Manual defines object codes.

We recommend the Department develop and implement procedures to ensure that individuals responsible for recording the Department's appropriation/cash transfer transactions are knowledgeable of the object codes as defined by the Comptroller General's STARS manual. Furthermore, we recommend the Department implement control procedures requiring an independent review of object codes.

ATTORNEY FEES APPROVAL

One of twenty-five transactions tested included a payment to a private attorney. The Department could not provide documentation demonstrating that the transaction had been approved by the Attorney General. The purpose of the transaction was to procure hearing officer services provided by a private attorney.

Proviso 32.2 of the fiscal year 2006 Appropriation Act states in part, “No department or agency of the State Government shall engage on a fee basis any attorney at law except upon the written approval of the Attorney General and upon such fee as shall be approved by him.”

We recommend that the Department request Attorney General approval for all payments to private attorneys, to include payments for hearing officer services. Controls should be in place to ensure that all attorney fees are approved by the Attorney General prior to being paid.

PROVISO 1.89 – EDUCATION AND ECONOMIC DEVELOPMENT ACT

During our review of Appropriation Act compliance we noted that the Department was not in compliance with Proviso 1.89. This proviso requires the Department use \$6 million of its appropriated funds to fund the Education and Economic Development Act. The Department did not meet the funding requirements of this proviso.

The Department did not comply with the proviso because it would have required them to reduce funding for other programs.

We recommend that the Department ensure and document compliance with all applicable provisos.

MANAGEMENT'S RESPONSE

GRANT/CONTRIBUTION REVENUES CLOSING PACKAGE

The Department's grant receivables and deferred revenues closing package included errors. Some of the calculation errors were the result of spreadsheet formula errors and the others were caused by the exclusion of the receipt of refunds of prior year expenditures. Based on our estimation, the errors caused an understatement of \$19,481 in deferred revenue and a \$19,923 overstatement of grants receivable.

Section 3.3 of the Comptroller General's GAAP Closing Procedures Manual requires an independent review of the closing package. The reviewer's checklist includes questions for the reviewer to verify and reconcile amounts reports.

We recommend that the Department ensure proper calculation of deferred revenue and grants receivable including accurate spreadsheet formulas, inclusion of refunds of prior year expenditures in the calculation, and a thorough review of the calculations.

Response:

The review process of this closing package will be modified beginning in FY08 to include a more thorough inspection of the grants analysis worksheet to insure that all formulas are accurately in place. Refunds of prior year expenditures will be analyzed as to their effect on deferred revenue and grants receivable and will be included in the appropriate column on a case by case basis.

INCORRECT PAY PERIOD

We found that three of the twenty-five newly hired employees tested were not paid in accordance with the State's pay schedule. One part-time employee who began work on August 25, 2005 did not receive his first paycheck until September 30, 2005. He should have been paid on September 16, 2005. Another employee began work on July 19 and received his first check on September 1. The third employee started on July 22 and received his first check on September 30. These employees should have been paid on August 16, 2005. The employees were not paid in accordance with the State's pay schedule because the employees' timesheets were not submitted timely.

Section 8-11-30 of the 1976 Code of Laws states, "To provide a regular and permanent schedule for payment of employees, the payroll period begins in June 2nd of the prior fiscal year with the first pay period ending on June 16 of the prior fiscal year. The payroll period continues thereafter on a twice monthly schedule as established by the State Budget and Control Board."

We recommend the Department implement procedures to ensure the timesheets of hourly employees are submitted timely to enable the employee pay to be in accordance with the State's pay schedule.

Response:

The Department is aware of the problem with submission of late time sheets. We have and continue to communicate with all offices, First Steps, GSSM, and GSAH that all time sheets and transactions (including all paperwork) must be submitted to the payroll office in a timely manner.

OBJECT CODE DESCRIPTIONS

We selected twenty-five receipt transactions and twenty-five disbursement transactions. In one of twenty-five receipt transactions and two of twenty-five disbursement transactions we found that the Department recorded the transactions using incorrect object codes. The Department used object code 1610 (Allocations EIA - South Carolina State University Paraeducator Program) to record an expenditure reimbursement received from a school district. This object code was also used on the two disbursement transactions. These disbursements recorded the transfer of technology initiative funds to school districts. The expenditure transactions also included a charge to object code 1682 (Allocations EIA - Parent Support) for a payment for family literacy (Object Code 1683), a charge to object code 1626 (Allocations EIA - Academic Assistance Act 135) for a payment for Adult Education (Object Code 1640), and a charge to object code 1643 for a payment for middle school initiative (Object Code 1634). Object code 1643 was not included in the Comptroller General's 2006 STARS manual. A similar exception was noted for a South Carolina Office of First Steps to School Readiness transaction processed by the Department.

Based on our review it appears that the Department has defined several minor object codes for Education Improvement Act (EIA) allocations that do not agree to the STARS definition. Object code definitions used by the Department should agree with those used by the Comptroller General's Office.

We recommend that the Department modify its chart of accounts to ensure that its object code descriptions are consistent with STARS.

Response:

The Department uses object code 1610 to make EIA payment to districts, other entities, and state agencies that are not specific to any line item appropriations. All refunds must be receipted in the object code where the funds were expended. The department is making an effort to change the definition in object code 1610 to best describe the activity. The incorrect use

of object code 1682 and 1626 was an error that will be corrected. Object code 1643 was used in error. When the error was discovered, a large number of journal vouchers would have been required. The Department decided to move the authorization from object code 1634 to object code 1643. Management will periodically review posted object codes for accuracy.

APPROPRIATION/CASH TRANSFER OBJECT CODES

Three of twenty-two Appropriation/Cash transfer transactions tested were coded to the wrong object code. Two of the transactions recorded proceeds from the sale of surplus equipment. The Department used object code 7855 (Sale of Works of Art and Historical Treasures - Capitalized) instead of object code 7859 (Sale of Machinery and Equipment - Non-Capitalized). The third transaction recorded the transfer funds to the Governor's School of Science and Math for the Junior Scholars Program. The Department used object code 1663 (Allocations EIA - Other State Agencies) instead of object code 1697 (Allocations EIA - Governor's School for Math and Science).

Sections 2.1.6.10 and 2.1.6.20 of the Comptroller General's Statewide Accounting and Reporting (STARS) Manual defines object codes.

We recommend the Department develop and implement procedures to ensure that individuals responsible for recording the Department's appropriation/cash transfer transactions are knowledgeable of the object codes as defined by the Comptroller General's STARS manual. Furthermore, we recommend the Department implement control procedures requiring an independent review of object codes.

Response:

The Department of Education will ensure that individuals responsible for recording transfers are knowledgeable of STARS object codes. Management will periodically review posted object codes for accuracy.

ATTORNEY FEES APPROVAL

One of twenty-five transactions tested included a payment to a private attorney. The Department could not provide documentation demonstrating that the transaction had been approved by the Attorney General. The purpose of the transaction was to procure hearing officer services provided by a private attorney.

Proviso 32.2 of the fiscal year 2006 Appropriation Act states in part, "No department or agency of the State Government shall engage on a fee basis any attorney at law except upon the written approval of the Attorney General and upon such fee as shall be approved by him."

We recommend that the Department request Attorney General approval for all payments to private attorneys, to include payments for hearing officer services. Controls should be in place to ensure that all attorney fees are approved by the Attorney General prior to being paid.

Response:

The Department of Education will request approval for payments to private attorneys regardless of the scope of their work. The Office of Procurement and Services will not issue any purchase orders for payments to private attorneys until approval is obtained from the Attorney General. In addition, the Office of Finance will not process any payments to private attorneys without a copy of the approval.

PROVISO 1.89 — EDUCATION AND ECONOMIC DEVELOPMENT ACT

During our review of Appropriation Act compliance we noted that the Department was not in compliance with Proviso 1.89. This proviso requires the Department use \$6 million of its appropriated funds to fund the Education and Economic Development Act. The Department did not meet the funding requirements of this proviso. The Department did not comply with the proviso because it would have required them to reduce funding for other programs. We recommend that the Department ensure and document compliance with all applicable provisos.

Response:

The Department agrees that the proviso required the use of \$6 million of its appropriated or authorized funds for the Education and Economic Development Act (EEDA). The proviso was added to the appropriation bill upon return of the appropriation bill by the House of Representatives to the Senate late in the session. In addition, a conference committee was also considering the EEDA bill (H.3155 - Act 88 of 2005). The FY 2006 Appropriation Act provided no line item appropriation for EEDA IAW in accordance with the fiscal impact statement. Department staff explained to the EEDA Conference Committee members that there was no line item appropriation for EEDA but the House had amended the appropriations bill and added proviso 1.89. Department staff also explained to the EEDA Conference Committee members that it was the Department's intent to meet this requirement with the FY 2006 appropriated line items for School to Work/Tech Prep in the amount of \$4,064,483 and High Schools that Work in the amount of \$1,000,000 and that both items supported the

EEDA. If this course of action was not acceptable, the Department would then have to reduce funding for other programs in order to provide an additional \$6 million. Department staff understood that the arrangement to use School to Work/Tech Prep in the amount of \$4,064,483 and High Schools that Work in the amount of \$1,000,000 to meet the requirement of the EEDA and Proviso 1.89 was acceptable.

In the future, the Department will seek to obtain more clearly documented directions when there is potential for misunderstanding resulting in noncompliance with provisos. Any verbal conversation with legislators or testimony before a conference committee will be followed by a memorandum of record or memorandum of agreement.

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