

State of South Carolina



Office of the State Auditor

1401 MAIN STREET, SUITE 1200
COLUMBIA, S.C. 29201

RICHARD H. GILBERT, JR., CPA
DEPUTY STATE AUDITOR

(803) 253-4160
FAX (803) 343-0723

June 29, 2006

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

This report resulting from the application of certain agreed-upon procedures to certain accounting records of the South Carolina Office of the Adjutant General for the fiscal year ended June 30, 2005, was issued by Scott McElveen, L.L.P., Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

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

Respectfully submitted,

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

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

RHGjr/trb

South Carolina Office of the Adjutant General

Independent Accountants' Report on

Applying Agreed-Upon Procedures

for the year ended June 30, 2005

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Independent Accountants' Report on Applying Agreed-Upon Procedures

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

We have performed the procedures described below, which were agreed to by the management of the South Carolina Office of the Adjutant General (the "Agency") and the South Carolina Office of the State Auditor (the "State Auditor"), solely to assist you in evaluating the accounting records of the Agency for the fiscal year ended June 30, 2005, in the areas addressed. The Agency's management is responsible for its financial records, internal controls and compliance with State laws and regulations. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the State Auditor. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and the associated findings are as follows:

1. Cash Receipts and Revenues

- We inspected selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the selected receipt transactions were adequate to detect errors and/or irregularities.
- We inspected selected recorded receipts to determine if the 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 to those of the prior year and we used estimations and other procedures to evaluate the reasonableness of collected and recorded amounts by revenue account.

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

2. Non-Payroll Disbursements and Expenditures

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

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Section A in the Accountants' Comments 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 internal controls over the selected payroll transactions were adequate to detect errors and/or irregularities.
- We inspected selected recorded payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS.
- We inspected payroll transactions for selected new employees and those who terminated employment and tested internal controls over these transactions.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement.
- We compared current year recorded payroll expenditures to those of the prior year; and compared the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computed the percentage distribution of recorded fringe benefit expenditures by fund source and compared the computed distribution to the actual distribution of recorded payroll expenditures by fund source to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account.

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

4. Journal Entries, Operating Transfers and Appropriation Transfers

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

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

5. General Ledger and Subsidiary Ledgers

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

We found no exceptions as a result of the procedures.

6. Reconciliations

- We obtained all monthly reconciliations prepared by the Agency for the year ended June 30, 2005, and inspected selected reconciliations of balances in the Agency's accounting record to those in STARS as reflected on the Comptroller General's reports to determine if they were accurate and complete. For the selected reconciliations, we determined if they were timely performed and properly documented in accordance with State regulations, recalculated the amounts, agreed the applicable amount to the STARS reports, determined if reconciling differences were adequately explained and properly resolved, and determined if necessary adjusting entries were made in the Agency's accounting records and/or in STARS.

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

7. Compliance

- We confirmed through inspection of payroll and non-payroll disbursement vouchers, cash receipts and other documents, inquiry of Agency personnel and/ or observation of Agency personnel performing their assigned duties, the Agency's compliance with all applicable financial provisions of the South Carolina Code of Laws, Appropriation Act, and other laws, rules, and regulations for fiscal year 2005.

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

8. Closing Packages

- We obtained copies of all purported closing packages as of and for the year ended June 30, 2005, prepared by the Agency and submitted to the State Comptroller General. We inspected them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records.

Our findings as a result of these procedures are presented in Section A in the Accountants' 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, 2005, prepared by the Agency and submitted to the State Auditor. We inspected it to determine if it was prepared in accordance with the State Auditor's letter of instructions; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records.

We found no exceptions as a result of the procedures.

10. Status of Prior Findings

- We inquired about the status of the deficiencies described in the findings reported in the Accountant's Comments section of our report on the Agency resulting from our engagement for the fiscal year ended June 30, 2004, to determine if adequate corrective action has been taken.

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

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

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

Scott McElveen, L.L.P.

Columbia, South Carolina
June 13, 2006

Accountants' Comments

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

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

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

Untimely Deposits of Receipts

Cash is submitted to armory personnel, at the various armories throughout the state, who are responsible for depositing the cash in the bank within seven days of receipt. After the deposit is made, the deposit slips are submitted to the finance department. In three out of twenty-five deposits tested, the armory personnel held the cash for more than seven days prior to deposit. The receipts held for more than seven days were for \$450, \$350 and \$500. Under these circumstances, there is an opportunity for misappropriation and no means of detection. State law is also violated, and the State is missing out on the opportunity to earn interest on the deposited cash.

In addition, out of twenty-five deposits tested, three were not accompanied by documentation supporting the date and amounts received. These included two deposits for \$945 and \$2,435 from the Columbia Armory that were for amounts paid for USC parking rentals. The other receipt in the amount of \$165.85 was not accompanied by a receipt documenting the date and amount. This receipt was for a rebate. Without an accompanying receipt, it is not possible to determine the date that the money was received, to verify the amount received, or to determine if the amount was recorded in the proper period.

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

Deposits Not Recorded in the Proper Fiscal Year

One deposit of twenty-five tested was not recorded in the proper fiscal year. The official receipt of \$97.08 was dated June 29, 2005 yet was not deposited until July 6, 2005. This deposit should have been accounted for in fiscal month 13 of fiscal year 2005 rather than fiscal month 1 of fiscal year 2006.

We recommend that the Agency develop and implement control procedures to ensure that all receipts are properly recorded in the correct fiscal year in accordance with state laws, rules and regulations, the Agency's policies, the Comptroller General's GAAP Closing Procedures Manual, and GAAP.

Expenditures Not Recorded in a Timely Manner

When testing disbursements, three vouchers out of the twenty-five tested which were originated by the Emergency Management Division were not recorded in a timely manner. One voucher was dated September 23, 2005 for a lodging expense reimbursement in the amount of \$217.80 for an overnight stay in Myrtle Beach for a Terrorism and Weapons of Mass Destruction Training conference, which occurred March 24-25, 2004. The employees who attended the conference were from South Carolina Department of Health and Environmental Control ("DHEC"). DHEC reimbursed the employee and requested reimbursement for the expense, as allowed by Federal grant, from Emergency Management Division/Office of the Adjutant General. The lapse between the incurred expense and the prepared voucher to reimburse the expense caused the expense to be recorded late. The second EMD voucher in question in the amount of \$17,663.28 was dated in December 2004 for the reimbursement for the Federal share of eligible expenses, up to the total grant award, Contract NO. EMA-2003-GR-5349 of October 2003 through March 2004. The supporting documentation for request of the reimbursement was dated received on March 5, 2004. This voucher should have been recorded in fiscal year 2004.

The third Emergency Management Division ("EMD") voucher in question was dated July 23, 2005 for a lodging expense reimbursement in the amount of \$54.45 for a night stayed in Myrtle Beach for a Terrorism and Weapons of Mass Destruction Training conference, which occurred March 24-25, 2004. The employees who attended the conference were from DHEC. DHEC reimbursed the employee and requested reimbursement for the expense, as allowed by Federal grant, from EMD/Office of the Adjutant General. The delay in processing the voucher caused the voucher to be recorded in the fiscal year ended June 30, 2005 rather than the fiscal year in which the expense was incurred, the year ended June 30, 2004.

We recommend that the Agency develop and implement control procedures to expedite the process of vouchering expenditures in order to ensure that expenses are recognized in the year they were incurred.

Expenditures Not Recorded in a Timely Manner (Continued)

Payroll Duties

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

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

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

No Supporting Documentation for Appropriation Transfer

There was no supporting documentation or proper explanation for one appropriation transfer in the amount of \$200,000 transferring funds from object code 1201 to 1721 in order to transfer funds to cover allocations to counties. The lack of documentation creates the possibility for misclassifications or misstatements of revenues or expenses in programs.

We recommend that the Agency develop and implement control procedures to require support for all agency appropriation/cash transfers.

Reconciliations

We reviewed the reconciliations for all funds and noted the following exceptions:

- The revenue and expenditure reconciliations were performed, signed, and dated by the preparer in a timely manner with the exception of one subfund. The Agency could not provide any reconciliations for this one subfund for six of thirteen months of the year ended June 30, 2005.
- Of the thirteen months that reconciliations were prepared, eleven were not signed and dated by the reviewer.

We detail tested all subfunds for two randomly selected months to determine if they were properly prepared and determined that they were not properly prepared and reviewed based on the facts below:

- Of the thirty-four subfunds tested, cash was not reconciled for thirteen subfunds in one month tested and eight subfunds in another month tested.
- The balances for certain subfunds could not be traced back to the general ledger for both months tested.
- The expenditures listed on the reconciliation could not be traced to STARS for one subfund for one month tested.

We recommend the Agency improve the process of completing reconciliations for all funds and projects to ensure compliance with STARS Manual requirements and to identify and correct errors in its accounting records and/or STARS as necessary. We also recommend that all reconciliations be reviewed and approved in writing by an appropriate official other than the preparer.

Capital Assets Closing Package

The State Comptroller General's Office obtains GAAP data from agency-prepared closing packages for the State's financial statements. Section 1.7 of the GAAP Closing Procedures Manual ("GAAP Manual") states 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 1.8 states, "Agencies should keep working papers to support each amount they enter on each closing package form." Section 3.9 of the GAAP Manual requires agencies to maintain full documentation to support each amount on the closing package.

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

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

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

Other Closing Packages

As noted in last year's report, the reviewer of the closing package did not use the reviewer checklist as required by GAAP Closing Package Instructions. We reviewed the fiscal year 2005's closing package and noted the reviewer checklist was not used for one closing package. The GAAP Manual recommends an effective review of each closing package and the underlying working papers to minimize closing package errors and omissions. To assist each agency in performing effective reviews, the State Comptroller General's Office requires a reviewer checklist to be completed for each closing package submitted.

We also noted that the Accounts Payable Closing Package was not submitted correctly to the Comptroller General's Office by the required due date. It was submitted prior to the due date, but it contained misstatements of the Emergency Management Division's disaster obligations. The obligations were subsequently corrected and the package resubmitted after the due date. We understand that the Agency was waiting for additional instructions from the Comptroller General's Office, and the Accounts Payable Closing Package was initially submitted with the expectation that it was subject to correction pending the receipt of additional instructions.

In the testing of twenty-five deposits we noted an instance where the finance department received \$140.87 on July 8, 2004 for May 2004 commissions. The amount was received after the cutoff deadline for deposits to be included in fiscal month 13. The amount should have been captured by the preparation of the miscellaneous receivables closing package. The Agency did not complete the Miscellaneous Receivables package, and the amount was not properly captured.

We recommend that the reviewer review all closing packages using the reviewer's checklist, and all closing packages be accurately submitted by the required due date to the Comptroller General's Office. In addition we recommend that the Agency's accounting department devise a more accurate method for estimating disaster obligations. An effective review is essential to minimizing closing package errors.

SECTION B – OTHER WEAKNESS NOT CONSIDERED MATERIAL AND/OR VIOLATION OF STATE LAWS, RULES OR REGULATIONS

The condition described below has been identified as a weakness subject to correction or improvement but it is not considered a material weakness or a violation of State Laws, Rules, or Regulations.

No Supporting Documentation for Hire Dates and Termination Dates

Hire dates and termination dates for cadets enrolled in the Youth Challenge program are not supported by documentation. Cadets have hire dates and termination dates that are not consistent with program requirements. The payroll department is not communicating with the program directors on a regular basis to determine that the information entered into the payroll system is consistent with the cadet records maintained by the program directors.

We recommend that the payroll department improve its communication with the Youth Challenge program directors. Documentation for each cadet’s hire date, termination date and qualification for the available stipends should be obtained from the program directors and maintained in the payroll department.

SECTION C – STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on the findings reported in the Accountants’ Comments Section of our report on applying agreed-upon procedures for the fiscal year ended June 30, 2004, and dated May 25, 2005. We determined that the Agency has taken adequate corrective action on each of the findings except for the following which have been repeated in Section A of this report.

2004 Comment Title

2005 Comment Title

Untimely Deposits of Receipts

Untimely Deposits of Receipts

Reconciliations

Reconciliations

Capital Asset Closing Package

Capital Asset Closing Package

Payroll Duties

Payroll Duties

Other Closing Packages

Other Closing Packages

The State of South Carolina
Military Department



OFFICE OF THE ADJUTANT GENERAL
1 NATIONAL GUARD ROAD
COLUMBIA, S.C. 29201-4766

STANHOPE S. SPEARS
MAJOR GENERAL
THE ADJUTANT GENERAL

JOHN A. SHULER
DEPUTY ADJUTANT GENERAL
STATE OPERATIONS

June 27, 2006

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

Dear Mr. Mobley:

The Office of the Adjutant General has completed its review of the agreed-upon-procedures report for the year ending June 30, 2005 and authorizes the release of this report. I am enclosing the Agency's response to your comments, which will be added to your report.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Frank L. Garrick", written in a cursive style.

Frank L. Garrick, CPA
Chief Financial Officer

Untimely Deposit of Receipts

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

Deposits Not Recorded in the Proper Fiscal Year

The funds were deposited on the last date of the Comptroller General's cut off date. Procedures will be reviewed to ensure that all deposits received by the Comptroller General's cut off date are recorded in the proper fiscal month.

Expenditures Not Recorded in a Timely Manner

The Agency is continuing to address its controls over the voucher process. We will reissue guidance regarding the time stamping of all documentation being received at the different locations. If a voucher package is not paid in a timely manner, a notation is to be attached with an explanation why it has been held and when it was ultimately released.

Payroll Duties

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

No Supporting Documentation for Appropriation Transfer

The Agency will reemphasize the procedure to backup all transactions with the proper documentation and have the transactions reviewed and signed off where appropriate.

Reconciliations

The Agency has continued to make significant improvements in the reconciliation process in the fiscal year 2005. A monthly checklist of all accounts has been prepared to track each fund by month and that each account was review and signed off. Due to a change in personnel and the time since the fund was established, we have been unable to reconcile one fund. This fund is to be force balanced and closed with a letter of explanation attached.

Capital Assets Closing Package

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

During the implementation of GASB **34**, the Agency and Comptroller General agreed to the proper reporting for such projects and assets. However, this will require large adjustments (in both numbers and dollars of assets) to our automated system. For closing package purposes, the Agency tried to make these adjustments "offline" and in the process made some closing package errors.

The Agency attempted to make organizational changes **at** the end of fiscal **2002** to improve the capital assets process; however, war activations resulted in a setback in these changes. Management now realizes that improvements will require the involvement of the accounting department and is undertaking a studied review to determine how to best reorganize staff to ensure that the needed improvements are made.

The Agency will conduct **a** periodic physical inventory on all property except equipment located at the armories throughout the state. Since most armories only have three or less pieces of state-owned equipment, it is not cost effective to independently inventory these. The Agency will develop procedures to have spot checks or other procedures done for equipment **at** armories.

Other Closing Packages

The Agency's goals are to always meet the deadlines and follow the procedures set for the by the Comptroller General. All reviewer checklists will be downloaded and used for each closing package submitted.

The accounting department received from the Controller General **a** more accurate method for estimating disaster obligations. This **was** used to correct the 2004 Closing Package and will be used for the 2005 Closing Package.

Accounts Payable and Accounts Receivable transactions that are expensed in the fiscal year, are posted in July but are not posted till the following fiscal year due to the cut off dates established by the Comptroller General are included in the accounts payable and the accounts receivable closing packages.