JOHN DE LA HOWE SCHOOL

MCCORMICK, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 1998

CONTENTS

<u>INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES</u>

May 28, 1999

The Honorable James H. Hodges, Governor
and
Board of Trustees
John de la Howe School
McCormick, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the John de la Howe School, solely to assist you in evaluating the performance of the School for the fiscal year ended June 30, 1998, 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 and, using estimations and other procedures, tested the reasonableness of collected and recorded amounts by revenue account. The individual transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

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 School, 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 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. We found no exceptions as a result of the procedures.

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 various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement. We performed other procedures, such as comparing current year payroll expenditures to those of the prior year; comparing the percentage change in personal service expenditures to the percentage change in employer contributions; and comparing the percentage distribution of recorded fringe benefit expenditures by fund source to the percentage 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 Pay at Termination of Employment and Personnel Records in the Accountant's Comments section of this report.

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

5. We tested selected entries and monthly totals in the subsidiary records of the School 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. We found no exceptions as a result of the procedures.

6. We obtained all monthly reconciliations prepared by the School for the year ended June 30, 1998, and tested selected reconciliations of balances in the School'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 School'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 School's accounting records and/or in STARS. The reconciliations selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

7. We tested the School'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 1998. Our findings as a result of these procedures are presented in Pay at Termination of Employment and Personnel Records 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 School resulting from our engagement for the fiscal year ended June 30, 1997, to determine if adequate corrective action has been taken. Our finding as a result of these procedures is presented in Personnel Records 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, 1998, prepared by the School 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 finding as a result of these procedures is presented in GAAP Closing Packages in the Accountant's Comments section of this report.

10. We obtained a copy of the schedule of federal financial assistance for the year ended June 30, 1998, prepared by the School 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. We found no exceptions as a result of the procedures.

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. Further, 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 School's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

The Honorable James H. Hodges, Governor
and
Board of Trustees
John de la Howe School
May 28, 1999

This report is intended solely for the information and use of the Governor and of the governing body and management of the John de la Howe School 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.

PAY AT TERMINATION OF EMPLOYMENT

For fiscal year 1998, we tested the calculations of the final pay of 25 of the 32 employees who terminated employment. The School incorrectly computed six of the tested payments. Such payment errors, as summarized below, indicate a weakness in accounting controls over payroll. Similar problems regarding incorrect payments to employees upon termination from School employment were reported by the auditors in fiscal years 1996, 1994, 1992 and 1991. (We performed no procedures to the School's records for fiscal years 1995 and 1993.)

Employee	Overpayment
1	$ 45
2	72
3	39
4	65
5	68
6	634
Total Overpayments	$923

Employees 1, 2 and 3

The School paid employee one based upon an incorrect annual salary rate; paid employee two for one day not worked; and paid employee three for 4.5 hours of compensatory leave in excess of the accumulated balance.

Section 8-11-30 of the 1976 South Carolina Code of Laws, as amended, states that it is unlawful for anyone to receive any salary from the State which is not due and for anyone employed by the State to pay salaries or monies that are not due. Any violation is punishable by a fine or imprisonment.

Employees 4 and 5

Employees four and five terminated employment prior to the optional holidays they had selected; however, the School paid each of them for an extra day. State Human Resources Regulation 19-703.06 C. 8. states, "Prior to the first day of January, each employee may select, in writing on a form provided by the agency, one additional holiday of his choice." Regulations 19-703.06 E. 3. and 6. explain the only circumstances under which holiday leave may be paid (i.e., holiday compensatory leave credits earned when an employee is required to be on the job). State law and regulations contain no provision to pay an employee for an optional holiday when that person terminates employment before the selected date.

Employee 6

The School paid employee six for 337.5 hours or 45 days of unused annual leave instead of paying the lesser amount derived by calculating 45 days less annual leave taken since the first day of January. In accordance with Section 8-11-620 of the 1976 South Carolina Code of Laws, as amended, State Human Resources Regulation 19-703.07 L. states, in part, the following:

> Upon termination from State employment, for reasons other than retirement or death, an employee may take both annual leave and a lump-sum payment for unused annual leave, but in no event shall such combination exceed forty-five (45) days in a calendar year.

We again recommend that the School use greater care when calculating the pay for terminating employees. The School should develop and implement control procedures to ensure that any final pay or payment for a partial payroll period is mathematically accurate and is in compliance with State law and State Human Resources Regulations. Information used in the computations (e.g., pay rate, actual hours worked in the pay period, unused annual leave balance as of the last day of work) should be agreed to the supporting documentation by someone independent of the payroll preparation. We further recommend that the School pursue recovery of the overpayments. When overpayments are collected, refunds of prior year budgetary general fund expenditures must be deposited to the State General Fund as required by Section 11-9-125 of the South Carolina Code of Laws.

PERSONNEL RECORDS

The School failed to complete annual Employee Performance Management System (EPMS) appraisals due during fiscal year 1998 for eleven of the 23 employees included in our test of 25 payroll transactions. In fact, the personnel files for eight of these employees did not contain any EPMS appraisals, and the last EPMS appraisals for the other three employees were completed in 1982, 1990, and 1991, respectively. A similar finding was included in the State Auditor's Report for the fiscal year ended June 30, 1997, and dated September 3, 1998. In addition, during the engagement for the fiscal year ended June 30, 1996, we discussed with management of the School a similar exception regarding the failure to prepare all annual appraisals when due.

State Human Resources Regulation 19-704.02 A. states the following:

> Each agency shall develop an Employee Performance Management System (EPMS) that shall function as an effective management tool within the agency and provide a sound process for the evaluation of the performance and productivity of its employees. … that meets the special needs of the agency. Any agency that does not develop an approved EPMS shall come automatically under the model system developed by the Office of Human Resources.

Further, State Human Resources Regulation 19-708.03 A. requires each agency to maintain copies of all annual performance appraisals in each employee's official individual personnel file.

We again recommend that the School timely complete annual performance evaluations and maintain copies of all annual EPMS documents in each employee's personnel file.

GAAP CLOSING PACKAGES

Introduction

The State Comptroller General obtains certain generally accepted accounting principles (GAAP) data for the State's financial statements from agency-prepared closing packages. The State's accounting system (STARS) is on the budgetary basis. We determined that the School submitted to the Office of the Comptroller General several incorrectly prepared and/or misstated fiscal year-end 1998 closing packages and failed to submit two required closing packages.

To accurately report the School's and the State's assets, liabilities, and current year operations, the GAAP closing packages must be complete and accurate. Furthermore, Section 1.8 of the Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) states that “Each agency’s executive director and finance director are responsible for submitting … closing package forms … that are: •Accurate and completed in accordance with instructions. •Complete. •Timely." Also, this section of the GAAP Manual requires an effective supervisory review of each completed closing package and lists the minimum review steps to be performed. Section 1.9 of the GAAP Manual provides that "Agencies should keep working papers to support each amount they enter on each closing package form."

The following outlines the errors we noted on certain 1998 closing packages.

Master Closing Package

As a result of incorrectly answering "No" to two questions on the Master Closing Package, the School did not complete two of the required closing packages. Section 2.0 of the GAAP Manual states, "The purpose of this closing package is to help each agency determine which of the other closing packages it must complete. It also tells the Comptroller General's Office what closing packages to expect from each agency."

Because the School received more than $100,000 in revenues from the sale of goods, services, and fixed assets, it should have completed the Miscellaneous Revenues Closing Package (as provided in Section 3.4 of the GAAP Manual). Furthermore, the School leased a building to a non-State entity and, therefore, was required to complete the Operating Leases - Lessor Closing Package (as provided in Section 3.20 of the GAAP Manual).

Cash and Investments

For the children's account as of June 30, 1998, the School reported a balance of $110,970, the checkbook balance prior to the last check written for the year. The bank and book balances were each $110,909, so the School overstated the cash balance by $61. Section 3.1 of the GAAP Manual states, "The book balance of a bank account is the balance on your accounting records or in your checkbook on June 30."

Fixed Assets

Sections 3.7 through 3.11 of the GAAP Manual outline the requirements for reporting agency fixed assets in accordance with GAAP and for preparing the closing packages. We noted that the School made the following errors on its fixed assets closing package forms:

1. The School changed its capitalization criteria from $500 to $1,000, but it understated "net corrections to prior year balances" by $7,710 by excluding certain of those items it deleted from its fixed assets inventory with values less than $1,000. Consequently, it also overstated the June 30, 1998, equipment balance by $7,710 on the General Fixed Assets Summary Form.

2. The School could not reconcile the balance of $813,055 reported on the General Fixed Assets Summary Form at June 30, 1998, to its detail equipment listing balance of $1,255,455 at June 30, 1998, a difference of $442,400. The difference is partly attributable to the School's failure to promptly update its detail equipment listing. When the School did update the listing in August 1998, it included several fiscal year 1999 acquisitions in the listing that it intended to be accurate as of June 30, 1998.

3. The School reported equipment “retirements” of $101,552 on the fiscal year 1998 Fixed Assets Summary Form. However, the number of items and total values of fiscal year 1998 disposals per the School's detail listing were the same as those reported on the fiscal year 1997 detail listing as fiscal year 1997 disposals: 127 items totaling $127,064.

Recommendations

We recommend that the School implement procedures to ensure that all future closing packages contain accurate and complete information in accordance with the GAAP Manual requirements and instructions. We recommend that the School design and follow procedures to ensure that for each closing package the independent comparison of amounts used in calculations to the source records, independent verification of the computations, and independent review by someone knowledgeable of GAAP and familiar with the GAAP Manual. When the School's employees who are responsible for preparing and reviewing closing package forms do not understand the forms and/or the instructions, they should contact the Office of the Comptroller General for assistance. We also recommend that the School properly adjust the fixed assets balances as of June 30, 1998, on its fiscal year 1999 closing packages.

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 School for the fiscal year ended June 30, 1997, and dated September 3, 1998. We determined that the School has taken adequate corrective action on the findings regarding charging salary and allocating health and dental insurance to the proper fund sources, but we have repeated the comment regarding timely preparation of EPMS appraisals and maintenance thereof in personnel records. (See Section A of the Accountant’s Comments section of this report.)

MANAGEMENT'S RESPONSE