

**SOUTH CAROLINA DEPARTMENT OF
DISABILITIES AND SPECIAL NEEDS**

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 2007

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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

March 19, 2008

The Honorable Mark Sanford, Governor
and
Members of the Disabilities and Special Needs Commission
South Carolina Department of Disabilities and Special Needs
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the South Carolina Department of Disabilities and Special Needs (the Department), solely to assist you in evaluating the performance of the Department for the fiscal year ended June 30, 2007, 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 (\$38,100 – general fund, \$508,200 earmarked fund, \$10,800 – restricted fund, and \$6,900 – 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. Our finding as a result of these procedures is presented in Deposits in the Accountant's 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 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 (\$381,600 – general fund, \$508,700 – earmarked fund, \$10,200 – restricted fund, and \$7,100 – federal fund) and ± 10 percent.

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

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 (\$381,600 – general fund, \$508,700 – earmarked fund, \$10,200 – restricted fund, and \$7,100 – 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 ± 5 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 Payroll Transactions 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 journal entries selected were chosen randomly. We found no exceptions as a result of the procedures.

5. **General Ledger and Subsidiary Ledgers**

- We inspected selected entries and monthly totals in the subsidiary records of the 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 Department for the year ended June 30, 2007, 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 Department's compliance with Appropriation Act general and agency specific provisos.

We found no exceptions as a result of the procedures.

8. **Closing Packages**

- We obtained copies of all closing packages as of and for the year ended June 30, 2007, prepared by the Department 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 Litigation 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, 2007, 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.

Our findings as a result of these procedures is presented in Accounting and Reporting of Federal Activity in the Accountant's Comments section of this report.

The Honorable Mark Sanford, Governor
and
Members of the Disabilities and Special Needs Commission
South Carolina Department of Disabilities and Special Needs
March 19, 2008

10. **Status of Prior Findings**

- We inquired about the status of the findings reported in the Accountant's Comments section of the State Auditor's Report on the Department resulting from our engagement for the fiscal year ended June 30, 2006, to determine if the Department had taken corrective action.

We found no exceptions as a result of the procedures.

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 Department and is not intended to be and should not be used by anyone other than these specified parties.



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

ACCOUNTANT'S COMMENTS

SECTION A - 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.

DEPOSITS

During our tests of cash receipts and revenue cut-off, we identified two receipt input documents (# 31104 and # 31389) which contained receipts that were not deposited in a timely manner. In the first instance, the deposit was made approximately two weeks after receipt and appears to have occurred due to an agency oversight. In the second instance, the deposit was made approximately four weeks after receipt because receipts for insurance cash payments were accumulated over a period of time by the Human Resources function and submitted as a batch to the Finance function for deposit. General Proviso 72.1 of the fiscal year 2007 Appropriations Act requires that all general State revenues derived from taxation, licenses, fees, or from any other source whatsoever, be remitted to the State Treasurer at least once each week, when practical.

We recommend that the Department review and strengthen its procedures to ensure that receipts are deposited timely in accordance with Proviso 72.1.

PAYROLL TRANSACTIONS

We tested the Department's compliance with its internal control procedures and laws and regulations affecting personnel and payroll practices. During our tests of new hires and terminations, we noted that three employees received overpayments totaling \$157 caused by keying errors during the data entry process.

A strong system of internal controls over payroll transactions requires that all calculations and data entry results be checked for accuracy. In addition, South Carolina Code of Laws section 8-11-30 (A) states "It is unlawful for a person: (1) to receive a salary from the State or any of its departments which is not due; or (2) employed by the State to issue vouchers, checks, or otherwise pay salaries or monies that are not due to state employees..."

We recommend that the Department review and modify, as appropriate, its control procedures over new hire and termination pay to ensure that payroll transactions are processed accurately. Additionally, we recommend that the Department attempt to recoup the overpayments from the former employees if practicable.

LITIGATION CLOSING PACKAGE

The Office of the Comptroller General obtains certain generally accepted accounting principles (GAAP) data for the State's financial statements from agency prepared closing packages. The following outlines the errors and omissions noted on the litigation closing package.

- The preparer of the Litigation Contingency Report Forms (GAAP Form 3.13.4) indicated that the amount (or range of amounts) that each lawsuit asks of the State was unknown for ten of eleven cases reported. Without these amounts, the Comptroller General's Office cannot report the potential loss related to these cases in the State's financial statements. There was no evidence in the supporting working papers that the preparer was not able to determine reasonable estimates or obtain such amounts from the attorneys handling these cases. Therefore it is unclear whether these cases met the \$500,000 reporting threshold (either individually or in the aggregate for related cases) for inclusion on the closing package. In addition, although the Department submitted Litigation Contingency Report Forms for these cases, it did not report these cases in the summary section on the Litigation Overview Form.
- Expenditures made to private attorneys on the Payments to Private Attorney's Form (GAAP Form 3.13.2) were understated by \$2,079.

The Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) Reference 3.13 states "For all actual and threatened litigation cases that were pending for your agency at June 30, all that have arisen since June 30, any others that were reported last year

on a Litigation Contingency Report Form, and for payments made to private attorneys during the current fiscal year:

- Complete a Litigation Overview Form (GAAP Form 3.13.1). Copy this form as necessary to include all situations.
- Complete the Payments to Private Attorneys Form (GAAP Form 3.13.2), Settled Litigation Report Forms (GAAP Form 3.13.3) and Litigation Contingency Report Forms (GAAP Form 3.13.4) as instructed on the Litigation Overview Form (GAAP Form 3.13.1). Note: Most lawsuits/contingent situations should be reported both on the Litigation Overview Form and on one of the other forms.”

In addition, the General Instructions for GAAP Form 3.13.1 states “List all settled (S and N) situations, but list contingent (C) situations only if the potential gain or loss is \$500,000 or more. Exception: Report all cases within a group of related cases if the total potential gain or loss for the entire group of cases is \$500,000 or more. Show by bracketing or identify in some other manner the cases that form a group of related cases.” Reference 1.7 of the GAAP Manual states that an adequate internal control system includes safeguards to ensure that your agency detects and corrects its own closing package errors. Whenever the Comptroller General's Office or auditors detect errors, it means that your agency's system of internal control could be stronger”. Reference 1.7 further states that a supervisory employee should perform a review that includes tracing all amounts from the appropriate agency accounting records or other original sources to the working papers and finally to the closing package itself. Furthermore, GAAP requires that a reasonable estimate be made for the amount (or range of amounts) of potential loss.

We recommend that the Department’s personnel responsible for preparing and reviewing the Litigation Closing Package carefully review the instructions outlined in the GAAP Manual and prepare the closing package according to the instructions. In addition, the

Department should maintain documentation of its efforts to obtain reasonable estimates of amounts of potential loss including correspondence with attorneys or document reasons that estimates cannot be made.

ACCOUNTING AND REPORTING OF FEDERAL ACTIVITY

We tested the Department's fiscal year 2007 schedule of federal financial assistance (SFFA) and noted several errors:

- 1) The Department totaled amounts for individual grants by federal grantor rather than by federal program (CFDA 84.027).
- 2) The beginning cash balances and receipts for projects 0005-60 (CFDA 84.027) and 0007-60 (CFDA 84.173) did not agree with the Comptroller General's CSA 467 report. This discrepancy occurred because the Department prepared the SFFA using its TAG accrual basis accounting system rather than the Comptroller General's STARS cash basis accounting system. Grant cash received in fiscal year 2007 was recognized in fiscal year 2006 in TAG and in fiscal year 2007 in STARS. Consequently, the error overstated beginning cash balance and understated receipts \$43,106 for project 0005-60 and overstated beginning cash balance and understated receipts \$5,581 for project 0007-60.
- 3) The SFFA identified certain Federal programs (CFDA 10.550, CFDA 10.553, and CFDA 10.555) that were not included on the Comptroller General's CSA 467 report which summarizes all activity within the federal subfund 5XXX. This discrepancy occurred because the Department recorded activity related to these federal programs to subfund 3XXX rather than to subfund 5XXX as required by the Comptroller General's Office.

- 4) Activity for CFDA 93.779 is reported under one phase code on the SFFA but recorded to two different phase codes on the Comptroller General's CSA 467 report. Department personnel told us that they used the data from the Department's accounting records rather than the CSA 467 report because CFDA 93.779 is a three-year program and should be reported in only one phase code. However, the Department processed STARS vouchers using both phase codes during the year and has not made the necessary corrections to the Comptroller General's records to correct the error.

The State Auditor's Office provides a letter of instruction to each State agency for the proper completion of the SFFA. In addition, the STARS Manual describes the federal fund as follows:

- Accounts for financial transactions associated with funds received from the federal government, either directly or as an allocation from another agency.
- Federal subfund numbers are in the 5xxx series (e.g. 5055)

We recommend that the Department ensure that the SFFA is prepared and independently reviewed by staff that is knowledgeable of the requirements of the State Auditor's letter of instruction and STARS Manual requirements. Additionally, we recommend the Department implement procedures to strengthen the review process for detecting errors on its SFFA. Further, the Department should prepare STARS correcting entries to ensure that grant activity is properly reflected in the CSA 467 report.

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 Department for the fiscal year ended June 30, 2006, and dated May 10, 2007. We determined that the Department has taken adequate corrective action on each of the findings.

MANAGEMENT'S RESPONSE

SOUTH CAROLINA DEPARTMENT OF DISABILITIES AND SPECIAL NEEDS

MANAGEMENT'S RESPONSE FOR THE FISCAL YEAR ENDED JUNE 30, 2007

SECTION A – VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS

Deposits

Two receipt input documents were identified which contained receipts that were not deposited in a timely manner.

Recommendation...that the Department review and strengthen its procedures to ensure that receipts are deposited timely in accordance with Proviso 72.1

Action Taken: The Department will review its practices to ensure all receipts are deposited timely.

Payroll Transactions

During tests of new hires and terminations, it was noted that three employees received overpayments totaling \$157 caused by keying errors during the data entry process.

Recommendation...that the Department review and modify, as appropriate, its control procedures over new hire and termination pay to ensure that payroll transactions are processed accurately. Additionally, we recommend that the Department attempt to recoup the overpayments from the former employees if practicable.

Action Taken: The Department has implemented a uniform methodology and standard format working papers for performing salary and wage calculations which includes approvals by the regional HR Director. Procedures will be reviewed to ensure adequate review is made for possible keying errors once entered into the HR/Payroll system. Further, the Department has instituted procedures to provide for routine testing of new and final compensation to ensure compliance with policy, supervisory review and adequacy of supporting documentation. When errors are detected, the Department pursues collection of any overpaid amounts to the fullest extent practicable.

Litigation Closing Package

The following errors and omissions were noted on the litigation closing package.

- Ten of eleven cases noted had no estimate of the potential loss and there was no evidence in the supporting working papers that the preparer was unable to obtain such reasonable estimates from the attorneys handling these cases. As a result it is unclear whether these cases meet the \$500,000 reporting threshold established by the Comptroller General.
- Expenditures made to private attorneys were understated by \$2,079

Recommendation...that the Department personnel responsible for preparing and reviewing the Litigation Closing Package should maintain documentation of its efforts to obtain reasonable estimates of amounts of potential loss including correspondence with attorneys or document reasons such estimates can not be made.

Action Taken: The Department will implement standard procedures to document the attempts to obtain reasonable estimates of potential loss from any outsourced litigators. In the event such estimates are unable to be reasonably made, the reasons for such shall be documented in support of that assertion. All payments to private attorneys will be reconciled and reviewed for completeness and accuracy prior to completion of the Litigation Closing Package.

Accounting and Reporting of Federal Activity

The following errors were noted:

- The Department totaled amounts for individual grants by federal grantor rather than by federal program
- Beginning cash balances for two projects did not agree with the Comptroller General's CDA 467 report
- The Schedule contained activity that was not noted on the Comptroller General's CDA 467 for programs accounted for within subfund 3XXX rather than subfund 5XXX as required by the Comptroller General's Office.
- CFDA 93.779 was reported on the schedule under one phase code, but recorded under two phase codes on the CDA 467 report.

Recommendation...that the Department ensure that the SFFA is prepared and independently reviewed by staff knowledgeable of the requirements of the State Auditor's letter of instruction and STARS Manual requirements and that the Department implement procedures to strengthen the review process for detecting errors on the SFFA. Further the Department should prepare STARS correcting entries to ensure that grant activity is properly reflected in the CSA 467 report.

Action taken: The Department will ensure proper review of the SFFA to provide for reasonable detection of any errors and will explicitly follow the instructions promulgated by the State Auditor in regard to such. The Department will also ensure that any necessary adjustments to the STARS accounting system will be made in order that the CSA 467 will properly reflect grant activity.

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