

June 30, 1999

The Honorable James H. Hodges, Governor
and
Members of the Commission
South Carolina Department of Mental Health
Columbia, South Carolina

This report on the application of agreed-upon procedures to the accounting records of the South Carolina Department of Mental Health for the fiscal year ended June 30, 1998, was issued by Rogers & Laban, PA, 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,

Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/sj

**SOUTH CAROLINA DEPARTMENT OF MENTAL HEALTH
STATE OF SOUTH CAROLINA**

COLUMBIA, SOUTH CAROLINA

**INDEPENDENT ACCOUNTANT'S REPORT ON
APPLYING AGREED-UPON PROCEDURES**

JUNE 30, 1998

**SOUTH CAROLINA DEPARTMENT OF MENTAL HEALTH
STATE OF SOUTH CAROLINA**

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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

Mr. Thomas L. Wagner, Jr., CPA,
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 State Auditor and the South Carolina Department of Mental Health (the Department), solely to assist you in evaluating the performance of the Department 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 was supported by law. We compared current year recorded revenues from sources other than State General Fund appropriations with those of the prior year. 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 Department; 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 with 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, computing the percentage distribution of fringe benefit expenditures by fund source and comparing the computed distribution to the actual distribution of recorded payroll expenditures by fund source to determine if recorded payroll and fringe benefit expenditures were reasonable by expenditure account. The individual transactions selected for testing were chosen randomly. We found no exceptions as a result of the procedures.

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 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 totals were accurately posted to the general ledger; and the internal accounting controls over the tested transactions were adequate. The items 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 Department for the year ended June 30, 1998, and tested selected reconciliations of balances in the Department's accounting records to those in the State's accounting system (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 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 STARS. The reconciliations selected for testing were chosen randomly. We found no exceptions as a result of the procedures.
7. We tested the Department'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 finding as a result of these procedures is presented in comment 2 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 Department resulting from the engagement for the fiscal year ended June 30, 1996 to determine if adequate corrective action has been taken. We applied no procedures to the Department's accounting records and internal controls for the year ended June 30, 1997. We found no exceptions as a result of the procedures.
9. We obtained copies of all closing packages as of and for the year ended June 30, 1998, prepared by the Department and submitted to the State Comptroller General. We reviewed them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements; if the amounts were reasonable; and if they agreed with the supporting workpapers and accounting records. Our findings as a result of these procedures are presented in comments 1, 3, 4 and 5 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 Department 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 Department's financial statements or any part thereof, other matters might have come to our attention that would have been reported to you.

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

Columbia, South Carolina
June 25, 1999

**SOUTH CAROLINA DEPARTMENT OF MENTAL HEALTH
STATE OF SOUTH CAROLINA

ACCOUNTANT'S COMMENTS
JUNE 30, 1998**

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

The procedures agreed to by the Office of the State Auditor and the Department 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 Department 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 elements do 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.

1. FIXED ASSETS

The \$3,565,842 amount shown for construction commitments in item 9 of the fixed asset questionnaire was overstated because it included approximately \$465,000 in accounts payable and retainages payable as of June 30, 1998.

Section 3.7 of the GAAP Closing Procedures Manual prepared by the Comptroller General states that construction commitments shall be computed as follows:

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

We recommend that the instructions in the GAAP Closing Procedures Manual be adhered to in the preparation of closing packages.

2. VENDOR INVOICES NOT TIMELY PAID

Our test of 25 vouchers disclosed one that was not paid timely. Invoices to one vendor dated November 17, 1997; January 29, 1998 and February 24, 1998 were not paid until August 5, 1998. The Department could not provide an explanation for the delay in paying the vendor.

State policies require that vendors be paid within 30 working days.

We recommend that the Department implement procedures to ensure that all vendor invoices are paid in a timely manner.

3. ALLOWANCES FOR DOUBTFUL LOANS AND PATIENT ACCOUNTS RECEIVABLE UNDERSTATED

The Department made a \$500,000 loan prior to June 30, 1996 to a corporation. The loan agreement required a repayment schedule to be agreed to with payments to start no later than June 30, 1996 and the loan being paid in full no later than June 30, 2000. No payments have been received on the loan and per discussions with Department personnel it does not appear that the loan is fully collectible. No allowance for uncollectible loans was reported on the closing package.

Also, the Department's allowance for uncollectible accounts receivable for clinic patient receivables appears to be understated. The Department reported approximately \$3,980,000 in the closing package and after our discussions with Department personnel they revised their schedule to approximately \$4,620,000. The Department was not taking the mix by patient types of ending receivables into account in calculating the allowance.

Generally accepted accounting principles require that receivables be reported at their net collectible amounts. Sections 3.4 and 3.5 of the GAAP Closing Procedures Manual require the Department to record an allowance for receivables that are not reasonably expected to be collected.

We recommend that the Department review its methods to ensure the adequacy of the amount reported as allowances for uncollectible loans and account receivables.

SECTION B - OTHER WEAKNESSES NOT CONSIDERED MATERIAL

The conditions described in this section have been identified as weaknesses subject to correction or improvement but they are not considered material weaknesses or violations of State Laws, Rules, or Regulations.

4. CLOSING PACKAGE ERRORS

Our review of the documentation supporting the closing package for accounts payable disclosed that the Department included a voucher payable to another State Agency and also included an amount of \$850 due from a vendor as a payable to the vendor. Also, the operating lease closing package had a future lease commitment for one of the leases understated by \$2,000.

Section 3.12 of the GAAP Closing Procedures Manual requires the Department to exclude amounts payable to another State Agency. Vendor credits are receivables, not payables.

The inclusion of the credit memo as a payable and the error in the lease schedule appeared to be due to the lack on an adequate review.

We recommend that additional care be taken in the preparation of schedules supporting the closing packages.

5. RECEIVABLES AND ALLOWANCES OVERSTATED

The Department is not reducing its account receivables and related allowance for patient account receivables that have been determined to be bad debts. State law does not allow the Department to write off receivables as bad debts but generally accepted accounting practice requires that the receivable and related allowance be periodically reduced for bad debts. As a result the gross inpatient account receivables and allowance has been increasing \$30 to \$40 million per year. The amount reported in the closing package was approximately \$728 million in receivables with a \$715 million allowance. A similar situation appears to exist with clinic patient account receivables.

Generally accepted accounting principles require that the receivables and allowances be adjusted periodically to charge off actual bad debts.

We recommend that the Department periodically adjust the reported amounts to reflect actual bad debts which should be charged off.

SECTION C - STATUS OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Comments section of the State Auditor's Report on applying agreed-upon procedures on the Department for the fiscal year ended June 30, 1996, dated June 26, 1997. Neither the State Auditor's Office nor we applied any procedures to the Department's accounting records and internal controls for the year ended June 30, 1997. We determined that the Department has taken adequate corrective action on each of the deficiencies that were included in the prior report.

MANAGEMENT'S RESPONSE

Attachment A

SOUTH CAROLINA DEPARTMENT OF MENTAL HEALTH

June 29, 1999

Rogers & Laban, PA
P.O. Box 124
Columbia, South Carolina 29202

We have reviewed your accountant's comments and recommendations under the headings of "Fixed Assets," "Vendor Invoices Not Timely Paid," "Allowances for Doubtful Loans and Patient Accounts Receivable Understated," "Closing Package Errors," and "Receivables and Allowances Overstated" pertaining to your examination of agreed upon procedures for the year ending June 30, 1998.

We agree with your recommendations under these headings and will institute procedures for their corrective action.

Sincerely,

John D. Bourne, CPA, Director
Division of Financial Services

JDB:lm