

**SOUTH CAROLINA STATE AGENCY
OF VOCATIONAL REHABILITATION
WEST COLUMBIA, SOUTH CAROLINA**

STATE AUDITOR'S REPORT

JUNE 30, 2003

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State of South Carolina



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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

July 9, 2004

The Honorable Mark Sanford, Governor
and
Board of Directors
South Carolina State Agency of Vocational Rehabilitation
West Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the governing body and management of the South Carolina State Agency of Vocational Rehabilitation (the State Agency), solely to assist you in evaluating the performance of the State Agency for the fiscal year ended June 30, 2003, in the areas addressed. The State 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 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 and internal controls over the selected receipt transactions were adequate to detect errors and/or irregularities.
- 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 from sources other than State General Fund appropriations 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.
- We inspected the cooperative agreements the State Agency has with other state agencies and verified the services were provided and the correct amounts were collected.

The individual transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Accounting System 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, were bona fide disbursements of the State 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 finding as a result of these procedures is presented in Accounting System in the Accountant's Comments section of this report.

3. **Payroll Disbursements and Expenditures**

- We inspected selected recorded payroll disbursements to determine if the selected payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements; and internal controls over the selected payroll transactions were adequate to detect errors and/or irregularities.
- 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 internal controls over these transactions were adequate.
- 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; 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 Workers' and Unemployment Compensation Insurance and Termination Pay in the Accountant's Comments section of this report.

4. **Journal Entries and Operating Transfers**

- We inspected selected recorded journal entries and operating 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. 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 State 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.

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

6. **Reconciliations**

- We obtained all monthly reconciliations prepared by the State Agency for the year ended June 30, 2003, and inspected selected reconciliations of balances in the State Agency'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 determined if they were timely performed and properly documented in accordance with State regulations, recalculated the amounts, agreed the applicable amounts to the State Agency'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 State Agency's accounting records and/or in STARS.

We judgmentally selected the fiscal year-end reconciliations and randomly selected one month's reconciliations for testing. Our findings as a result of these procedures are presented in Reconciliations and Workcenter Composite Bank Account in the Accountant's Comments section of this report.

The Honorable Mark Sanford, Governor
and
Board of Directors
South Carolina State Agency of Vocational Rehabilitation
July 9, 2004

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 State 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 2003.

Our findings as a result of these procedures are presented in Reconciliations and Workers' and Unemployment Compensation Insurance in the Accountant's Comments section of this report.

8. **Closing Packages**

- We obtained copies of all closing packages as of and for the year ended June 30, 2003, prepared by the State 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 Closing Packages in the Accountant's Comments section of this report.

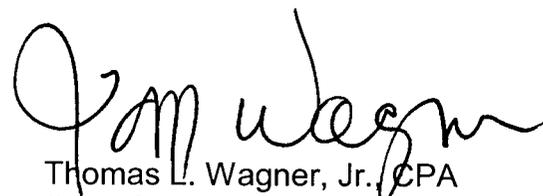
9. **Status of Prior Findings**

We inquired about the status of the deficiencies described in the findings reported in the Accountant's Comments section of the State Auditor's Report on the State Agency resulting from our engagement for the fiscal year ended June 30, 2002, to determine if adequate corrective action has been taken.

Our findings as a result of these procedures are presented in Section B in the Accountant's 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 and of the governing body and management of the South Carolina State Agency of Vocational Rehabilitation 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.

RECONCILIATIONS

We noted the following deficiencies while testing State Agency reconciliations and from our review of State Agency reconciliation procedures:

1. The State Agency finance personnel did not prepare a reconciliation of revenue by subfund and object code or a reconciliation of expenditures by subfund.
2. Some of the reconciliations did not contain evidence that a review had been performed. Other reconciliations were signed by the reviewer but the date of the review was not documented.
3. Workcenter account reconciliations were performed for cash balances only. Monthly reconciliations of workcenter revenue and expenditure accounts were not prepared.

Section 2.1.7.20 C. of the Comptroller General's Policies and Procedures Manual (STARS manual) requires that all agencies perform regular monthly reconciliations between their accounting records and STARS to ensure timely detection and correction of errors. Separate reconciliations should be performed of cash, revenue and expenditure accounts and must be performed at the level of detail in the Appropriation Act. Reconciliations must be performed at least monthly on a timely basis (i.e., shortly after month-end), be documented in writing in an easily understandable format with all supporting workpapers maintained for audit purposes, be signed and dated by the preparer, and be reviewed and approved in writing by an appropriate agency official other than the preparer. Furthermore, the STARS manual states that errors discovered through the reconciliation process must be promptly corrected in the agency's accounting records and/or STARS as appropriate. The manual also states that a cash reconciliation alone is not sufficient because it does not provide sufficient assurance that receipt and disbursement transactions are properly processed and that revenues and expenditures are correctly classified.

A similar finding was described in the fiscal year 2002, 2001 and 2000 reports. According to management, the State Agency cannot perform a reconciliation of expenditures by subfund or reconciliations of revenue by subfund and object code because the State Agency's accounting system cannot generate the reports the finance staff needs to perform such reconciliations. We were told by finance personnel that a revenue report was created in fiscal year 2004 that provides the required detail and the State Agency hopes to begin reconciling revenue by subfund and object code in fiscal year 2005. An expenditure report still has not been developed.

We recommend the State Agency develop and implement procedures to ensure compliance with Section 2.1.7.20 C. of the STARS manual. In addition we recommend the State Agency perform timely reconciliations of its workcenter revenue and expenditure accounts to ensure that receipt and disbursement transactions are properly processed and that revenue and expenditures are correctly classified.

WORKCENTER COMPOSITE BANK ACCOUNT

During fiscal year 2003 and prior years the workcenter composite account was maintained with the Bank of America. In March 2003, the State Agency closed the Bank of America account and opened a new composite account with Wachovia. The State Agency transferred the cash balance remaining in the Bank of America account (\$391,434) to the Wachovia account. At the time the Bank of America account was closed, the State Agency had checks outstanding totaling \$19,669.

The State Agency performs monthly reconciliations of its workcenter cash accounts to the State Treasurer's Composite Bank Account Statement and to its books. The State Agency's June 2003 reconciliation listed one line item for "outstanding checks – Bank of America" of \$19,669 and listed another line item identified as "other-Bank of America" of \$36,129. The State Agency provided support for the outstanding checks but could not provide documentation to support the "other – Bank of America" reconciling item. According to finance personnel, the "other-Bank of America" amount was basically a "plug" figure used to balance State Agency's books with the composite account. Finance personnel speculate that the difference consists of bank and other miscellaneous charges dating back several years. We were told by finance personnel that they voided \$11,320 of the \$19,669 total of outstanding checks on its books and hopes to void the remaining amount in the future. However, attempts to void these checks on STARS were unsuccessful. According to finance personnel, no formal discussions have been held with representatives of the State Treasurer's Office concerning these reconciling items and the proper way to dispose of them.

Sound accounting practices require reconciliations to be performed and any reconciling items noted during the reconciliations process to be investigated and cleared in a timely manner. If reconciliations are not complete and proper, errors and irregularities may go undetected.

We recommend the State Agency further research and investigate all reconciling items listed on the reconciliations. We also recommend the State Agency take appropriate steps, including seeking instruction from appropriate state personnel, to ensure these items are properly disposed of.

ACCOUNTING SYSTEM

We compared fiscal year 2003 expenditures recorded in STARS to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account. We also compared fiscal year 2003 revenues recorded in STARS to those of the prior year to determine the reasonableness of collected and recorded amounts by revenue account. Finance personnel were unable to provide adequate explanations for significant expenditure and revenue variances in several accounts because the State Agency's financial accounting system could not generate the appropriate reports that would provide such information.

Activities relevant to financial reporting objectives consist of methods and records established to record, process, summarize and report entity transactions and to maintain accountability for the related assets, liabilities and equity. The quality of system-generated information affects management's ability to make appropriate decisions. To be effective, the information system should include an accounting system which provides for separate identification and allocation of transactions according to the entity's separate funding sources and reports that provide managers with timely and useful information.

We recommend the State Agency thoroughly review and evaluate the effectiveness and usefulness of its financial accounting system in order to improve its accounting and reporting.

TERMINATION PAY

To ensure that the State Agency accurately calculated employee pay at termination we selected 25 employees who separated from the State Agency. Based on the tests performed we determined that the State Agency incorrectly paid one employee whose salary was federally funded. Our review of documents contained in the employee's personnel file indicated that the employee resigned effective April 29, 2003. The State Agency paid the employee for the entire pay period even though she only worked 8.26 of the eleven days in the pay period. This error resulted in an overpayment of \$234. State Agency personnel could offer no explanation for this overpayment.

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.

We recommend that the State Agency develop and implement procedures to ensure that it adheres to State personnel laws, rules and regulations. The procedures should ensure that payroll calculations are independently reviewed to ensure that the calculations are correct. In addition, the State Agency should refund the overpayment to the Social Security Disability Insurance Program because the payment was an unallowable cost to the program. Finally we recommend that the State Agency pursue recovery from the former employee of the amount overpaid.

CLOSING PACKAGES

Introduction

The State Comptroller General obtains certain generally accepted accounting principles (GAAP) information from agency-prepared closing packages to use in preparing the State's financial statements. We determined that the State Agency submitted to the Comptroller General certain incorrectly prepared and/or misstated fiscal year-end 2003 closing packages.

To accurately report the Agency's and the State's assets, liabilities, and current year operations, the GAAP closing packages must be complete and accurate. Furthermore, Section 1.7 of the Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) states, "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, Section 1.7 requires an effective, independent supervisory review of each completed closing package and the underlying working papers and accounting records and completion of the reviewer checklist and lists the minimum review steps to be performed. In addition, Section 1.8 directs agencies to keep working papers to support each amount and other information they enter on each closing package form.

The following outlines the errors noted on certain 2003 closing packages.

Accounts Payable

The State Agency incorrectly reported earmarked payables on the accounts payable closing package, resulting in a \$40,775 overstatement. The State Agency incorrectly reported the total commitments at June 30, 2003 related to the Florence VR Center Annex – Re-roofing Project as an accounts payable instead of the portion related to retainage payable (\$3,875).

Finally, the State Agency reported payments totaling \$5,838 for goods and services received after June 30 as federal payables. The State Agency estimated additional payable based on this discrepancy, which resulted in a \$14,914 overstatement. This error also resulted in a similar overstatement reported on the grants/contributions receivables and deferred revenue closing package.

Section 3.12 of the GAAP Manual states that "Payables at June 30 are amounts owed for goods and services that your agency both

- Received on or before June 30.
- Paid for after June 30."

Capital Assets

The beginning and ending balances reported on the accumulated depreciation summary form did not agree to the State Agency's Depreciation Schedule Worksheets for Equipment and Vehicles (dated 9/29/03). Finance personnel stated that errors in the worksheets' formulas were noted after the closing package had been submitted to the Comptroller General. We were told that the errors in the worksheet formulas have been corrected; however, the State Agency was still unable to provide us with documentation that demonstrated that the worksheet agreed to the amounts reported on the summary form.

In addition, an asset included as a reconciling item on the State Agency's reconciliation of additions (telephone system - \$18,403) has not yet been added to the Agency's inventory listing. This asset was purchased before July 2003 and was paid for with fiscal year 2003 (fiscal month 13) funds, and therefore should have been included in the listing for fiscal year 2003. According to State Agency personnel, the asset was appropriately added to the listing; however, due to problems in the accounting system, it does not appear on the additions listing or the inventory listing.

Sections 3.8 through 3.11 of the GAAP Manual provide guidance for agencies reporting capital asset transactions and balances in closing packages. In addition, an effective internal control system requires that adequate supporting documentation be prepared and retained and financial and related information be properly recorded in the accounting and other agency records and be properly summarized in reports prepared therefrom.

Recommendations

We recommend that the State Agency implement procedures to ensure that all future closing packages contain accurate and complete information in accordance with the GAAP Manual instructions. As required by the GAAP Manual, the State Agency's closing package procedures should include an effective independent review before submitting the forms to the Comptroller General. Each closing package review at a minimum should ensure the accuracy and adequacy of support documentation; that source documentation supporting each closing package response (monetary and other) has been retained; the reasonableness of each closing package response; each response agrees to the closing package worksheets and other supporting documentation and to the accounting and other source records; the methodology and formulas used in the supporting documentation is valid; and the applicable Closing Package Reviewer Checklists have been completed. We also recommend the State Agency implement procedures to ensure the accuracy of its capital assets records.

WORKER'S AND UNEMPLOYMENT COMPENSATION INSURANCE

The State Agency paid one hundred percent of workers' and unemployment compensation insurance out of federal funds. In addition, the Agency paid neither unemployment nor workers' compensation insurance out of earmarked funds, even though certain workshop employees are paid from those funds. A similar finding was described in the fiscal year 2002, 2001 and 2000 reports.

Proviso 63B.1. of the fiscal year 2003 Appropriation Act states, "It is the intent of the General Assembly that any agency of the State Government whose operations are covered by funds from other than General Fund Appropriations shall pay from such other sources a proportionate share of the employer costs of retirement, social security, workmen's compensation insurance, unemployment compensation insurance, health and other insurance for active and retired employees, and any other employer contribution provided by the State for the agency's employees."

We recommend the State Agency establish and implement policies and procedures to ensure that workers' and unemployment compensation insurance costs are charged equitably among all of its funds.

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 State Agency for the fiscal year ended June 30, 2002, and dated July 11, 2003. The continuing deficiencies are described in Reconciliations and Workers' and Unemployment Compensation Insurance in Section A of the Accountants' Comments in this report.

We did not perform follow-up procedures on the prior comment "Schedule of Federal Financial Assistance." Follow-up on this comment was conducted during the Statewide Single Audit for the fiscal year June 30, 2003.

MANAGEMENT'S RESPONSE

**Agree-upon Procedures Audit
State Fiscal Year 2003**

Response to Accountant's Comments

Reconciliations

1. *The State Agency finance personnel did not prepare a reconciliation of revenues by subfund and object code or a reconciliation of expenditures by subfund.*
2. *Some of the reconciliations did not contain evidence that a review had been performed; however, the date of the review was not documented.*
3. *Workshop account reconciliations were performed for cash balances only. Monthly reconciliations of revenues and expenditures were not prepared.*

Monthly reconciliations of expenditure by subfund had been prepared for fiscal year 2003.

A new revenue report has been generated by the Information System Division, reconciliations of revenue by subfund and object codes can be prepared beginning fiscal year 2005.

Monthly reconciliations of revenues and expenditures for the workshops are being prepared in fiscal year 2004.

Workcenter Composite Bank Account

We recommend the State Agency further research & investigate all reconciling items listed on the reconciliation. We also recommend the State Agency take appropriate steps; including seeking instruction from appropriate state personnel, to ensure these items are properly disposed of.

The Finance staff concurs with this recommendation and will take the necessary steps to implement corrective action.

Accounting System

We recommend the State Agency thoroughly review and evaluate the effectiveness and usefulness of its financial accounting system in order to improve its accounting and reporting.

State Agency concurs with this recommendation.

Termination Pay

We recommend that the State Agency develop and implement procedures to ensure that it adheres to State personnel laws, rules and regulations. We recommend that the State Agency pursue recovery from the former employee of the amount overpaid.

The Human Resources Office concurs with this finding. The Department will work to strengthen its leave-without-pay reporting procedures to try to ensure this does not occur again. In addition, the Human Resources Office is attempting to contact the individual to seek reimbursement for the overpayment.

Closing Packages

We recommend that the State Agency implement procedures to ensure that all future closing packages contain accurate and complete information in accordance with the GAAP Manual instructions.

The Finance Staff concurs with this recommendation and will take the necessary steps to implement corrective action.

Workers' and Unemployment Compensation Insurance

We recommend the State Agency establish and implement policies and procedures to ensure that workers' and unemployment compensation insurance cost are charged equitably among all funds..

The Finance staff concurs with this recommendation. Beginning fiscal year 2004, Agency incorporates an cost allocation plan which will distribute the agency administrative expense between all grants equitably.

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