

STATE OF SOUTH CAROLINA

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT
AUDITING STANDARDS***

JUNE 30, 2015

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State of South Carolina
Office of the State Auditor



CliftonLarsonAllen

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Independent Auditors' Report

The Honorable Nikki R. Haley, Governor
and
Members of the General Assembly
State of South Carolina
Columbia, South Carolina

We have jointly audited, the financial statements of the governmental activities, the business type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of South Carolina (the State) as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated November 25, 2015. We conducted our joint audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the State Ports Authority, Connector 2000 Association, Inc., and South Carolina Medical Malpractice Liability Joint Underwriting Association, were not audited in accordance with *Government Auditing Standards* and accordingly this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the State Ports Authority, Connector 2000 Association, Inc., and South Carolina Medical Malpractice Liability Joint Underwriting Association. Our report includes a reference to other auditors who audited the financial statements of certain agencies and component units of the State of South Carolina, which represent the indicated percent of total assets and total revenues as described in our report on the State's financial statements and as presented in the following tables. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those other auditors.

	Percentage Audited by CliftonLarsonAllen LLP Separately		Percentage Audited by Other Auditors	
	Total Assets and Deferred Outflows of Resources	Total Revenue	Total Assets and Deferred Outflows of Resources	Total Revenue
<u>Government-wide</u>				
Governmental activities	2%	10%	63%	9%
Business-type activities	-	-	64%	79%
Component units	-	-	99%	99%

	Percentage Audited by CliftonLarsonAllen LLP Separately		Percentage Audited by Other Auditors	
	Total Assets and Deferred Outflows of Resources	Total Revenue	Total Assets and Deferred Outflows of Resources	Total Revenue
Fund Statements				
Governmental Funds	-	-	19%	8%
Enterprise Funds	-	-	64%	79%
Internal Service Funds	28%	88%	61%	8%
Fiduciary Funds	82%	26%	18%	74%
Discretely Presented Component Units	-	-	99%	99%

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, as described in the accompanying schedule of findings, that we consider to be material weaknesses. We consider deficiencies 2015-001, 2015-002, 2015-003, and 2015-004 as described in the accompanying schedule of findings to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of South Carolina's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State of South Carolina's Response to Findings

The State's responses to the findings identified in our audit are included in the section of this report titled "Management's Responses." The State's responses were not subjected to the auditing procedures applied in the joint audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Columbia, South Carolina
November 25, 2015



Baltimore, Maryland
November 25, 2015

MATERIAL WEAKNESSES

2015-001 FINANCIAL REPORTING – PREPARATION OF STATEWIDE ACCOUNTING RECORDS AND COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) – COMPTROLLER GENERAL’S OFFICE

Condition

Internal controls over financial reporting were inadequate to prevent or detect multiple misstatements during the preparation of the State’s CAFR and the supporting accounting records, which required the Comptroller General’s Office to post adjustments to the State’s CAFR.

Context

The Comptroller General’s Office is responsible for the reporting of State financial accounting data in the CAFR. Upon receipt of State agencies’ financial accounting data, the Comptroller General’s Office is responsible for compiling the State’s CAFR using the State agencies’ data, and recording statewide accounting adjustments to that data to properly reflect the State’s overall financial position at year end. There were misstatements in the draft version of the CAFR and the related financial accounting data which were not detected or corrected by the Comptroller General’s Office supervisory staff during the review process, and as a result, audit adjustments were recorded. These misstatements consisted of:

- The reporting of balances related to refund receivables included in accounts receivable that did not match the underlying accounting records and which could not be substantiated.
- Misstatements and classification issues related to the compilation of other audited entities for inclusion into the statewide CAFR.

Cause

The Comptroller General’s Office staff did not accurately compile and report financial accounting data during preparation of the CAFR. In addition, there was lack of adequate review by the Comptroller General’s Office supervisory staff, as errors were not detected during review.

Effect

Ineffective internal controls related to the preparation and fair presentation of the financial statements may prevent management from identifying material misstatements, due to error or fraud.

Criteria

Section 1.6, An Overview of the Year-End Reporting Process, of the Comptroller General’s Reporting Policies and Procedures Manual, states, “The Comptroller General’s Office will use SCEIS functionality to compile the statewide financial statements. Specifically, they will evaluate the completeness of SCEIS and identify and post entries necessary for GAAP compliance in SCEIS.” This policy acts as a control over financial reporting for the State’s financial statements.

Recommendation

We recommend additional procedures and controls be developed and implemented to ensure that the State's financial accounting data is reported accurately in the CAFR in accordance with Section 1.6 of the procedures manual referenced above and the data compiled by the Comptroller General's Office staff is adequately reviewed by appropriate personnel.

Response

See management's response on page 10.

2015-002 FINANCIAL REPORTING – RECONCILIATION OF CASH, CASH EQUIVALENTS AND INVESTMENTS – STATE TREASURER'S OFFICE

Condition

Internal controls over financial reporting were inadequate to prevent or detect misstatements while reconciling the amounts included in the reporting package submitted by the State Treasurer's Office (STO) and amounts reported in the South Carolina Enterprise Information System (SCEIS).

Context

The STO is authorized by law to account for the State's cash and investments on a system separate from SCEIS, at year end the STO prepares a year end reporting package which summarizes the State's cash, cash equivalents, and investment balances at year end. The STO's system (STARS) interfaces with SCEIS, however, the STO does not reconcile the amounts and transactions recorded in STARS or their submitted reporting package to SCEIS. During the Comptroller General's Office review of the STO reporting package and subsequent reconciliation to SCEIS, adjustments had to be posted in order to reconcile the two systems.

Cause

There are not adequate procedures or policies established to reconcile cash and investments balances between STARS and SCEIS.

Effect

Cash, cash equivalents, and investments reported in SCEIS did not reconcile to the amount of cash, cash equivalents, and investments reported by the STO, and as a result audit adjustments were recorded. Due to the volume of activity related to the State's cash and cash equivalents, it is probable that the magnitude of the difference in future years will have a material effect on the State's financial statements. In addition the inadequate reconciliation may prevent management from identifying misstatements, due to error or fraud.

Criteria

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Framework states that control activities are a component of internal control. Control activities are policies and procedures established to ensure that management directives are carried out, and consist of two elements, a policy that establishes what should be done and the procedure that implements the policy. COSO Framework states that control activities must be in place for there to be adequate internal control procedures over financial reporting. Internal control procedures affect the State's ability to ensure financial transactions are authorized and accurate. The preparation of reconciliations between ledgers and sub-ledgers is a key component of an entity's Internal Control Framework.

Recommendation

We recommend additional procedures and controls be developed and implemented by the STO to ensure that the cash and cash equivalents reported in STARS and provided in the reporting package are reconciled with SCEIS on a regular basis to ensure that the State's cash and cash equivalents are reported accurately and in accordance with GAAP.

Response

See management's response on page 12.

2015-003 FINANCIAL REPORTING – REPORTING OF LOSS LIABILITIES – DEPARTMENT OF SOCIAL SERVICES

Condition

The Department of Social Services (DSS) procedures and controls were inadequate to ensure proper reporting of loss liabilities resulting from violations of grant program rules. As a result the amount recorded for federal penalties was inaccurately reported.

Context

Loss liabilities payable resulting from violations of grant program rules should be accrued for annually and be reported in the year end reporting package. The agency's grant disallowance reporting package included loss liabilities for future years for which a violation had not yet occurred, and as a result, loss liabilities resulting from violations of grant program rules were overstated.

The violation of grant program rules was the result of the agency's failed compliance related to the functionality of an information technology system to use in conjunction with the grant program. As a final settlement had been reached with the prior third party vendor and a new vendor had been contracted, the agency recorded a liability for the expected completion date of the new system.

Cause

There was a lack of adequate review by DSS supervisory staff.

Effect

Ineffective design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements may prevent management from identifying a material misstatement, whether due to fraud or error.

Criteria

Internal control procedures affect an agency's ability to process financial transactions that are authorized and accurate. Section 1.7 of the Comptroller General's Reporting Policies and Procedures Manual states, "Each agency executive director and finance director are responsible for submitting to the Comptroller General's Office reporting packages that are accurate and prepared in accordance with instructions, complete, and timely." This requirement acts as a control over financial reporting for the State's financial statements.

Recommendation

We recommend additional procedures and controls be developed and implemented by DSS to ensure that the financial information provided in reporting packages are reported accurately in accordance with Section 1.7 of the manual referenced above. In addition, we recommend DSS management review their process for reporting the agency's financial information in the reporting packages, to ensure all agency staff preparing and reviewing the reporting packages have adequate knowledge and training to ensure significant financial events are reported in conformity with GAAP.

Response

See management's response on page 13.

2015-004 FINANCIAL REPORTING – REPORTING OF GRANT RECEIVABLES AND UNEARNED GRANT REVENUE – BUDGET AND CONTROL BOARD

Condition

Procedures and controls were inadequate to ensure proper reporting of unearned revenue balances on the agency's grant/contribution revenue reporting package. Balances were reported in the agency's reporting package that did not match the underlying accounting records.

Context

Grant receivables and deferred revenue should be calculated at the individual grant award level, as determined by the original award document from the grantor, in order to accurately capture the grant receivable and unearned grant revenue balances as of the fiscal year end. In order to properly determine the receivable or unearned revenue by grant award on the year end reporting package, the underlying data coded into the general ledger for each grant award must be accurate. An unearned revenue balance was reported by the agency which could not be substantiated.

Cause

There was a lack of adequate review by supervisory personnel.

Effect

Ineffective design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements may prevent management from identifying a material misstatement, whether due to fraud or error.

Criteria

Internal control procedures affect an agency's ability to process financial transactions that are authorized and accurate. Section 1.7 of the Comptroller General's Reporting Policies and Procedures Manual states, "Each agency's executive director and finance director are responsible for submitting to the Comptroller General's Office reporting packages that are accurate and prepared in accordance with instructions, complete, and timely." This requirement acts as a control over financial reporting for the State's financial statements.

Recommendation

While the agency followed the reporting package instructions correctly, we recommend additional procedures and controls be developed and implemented to ensure that the grant managers are accurately reporting grant activity to the correct sub-fund within the general ledger and that grant activity is accurately reported in the reporting package in accordance with Section 1.7 of the manual referenced above.

Response

See management's response on page 14.

SUMMARY OF PRIOR FINDINGS

During the current engagement, we reviewed the status of corrective action taken on the findings in the prior report on compliance and internal control over financial reporting at the basic financial statement level, dated December 22, 2014 to determine if the conditions still existed. Based on our audit procedures, we determined that the State has not taken adequate corrective action on the identified deficiencies 2014-001 and 2014-002. Therefore, we have repeated the comments at findings 2015-001 and 2015-002, respectively, in addition to current year specific findings. Comments 2014-03 through 2014-07 have not been repeated in this report.

MANAGEMENT'S RESPONSES



State of South Carolina
Office of Comptroller General

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RICHARD ECKSTROM, CPA
COMPTROLLER GENERAL

WILLIAM E. GUNN
CHIEF OF STAFF

January 27, 2016

Mr. George L. Kennedy, III, CPA
State Auditor
South Carolina Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, South Carolina 29201

Dear Mr. Kennedy:

Finding 2015-001 is misleading in its omission of essential details needed to comprehend the nature of the two "misstatements" cited in this finding. Also, the finding fails to acknowledge that our agency maintains a system of internal controls over financial reporting.

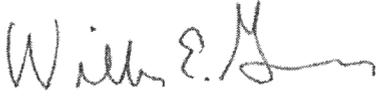
Regarding the first bullet that refers to a misstatement in a refund receivable, this refers to a situation in which two accountants in our agency were responsible for performing separate tasks in this area. One was responsible for reversing prior year accrual-conversion journal entries related to refunds receivable and the other accountant was responsible for preparing for the audit team working papers to support current year balances. Believing that the first accountant had completed his responsibilities, which he had not, the second accountant completed his own assigned responsibilities and provided the audit team the working paper he had prepared. Before a customary and planned supervisory review could be completed in this area, the audit team detected inconsistencies between the outputs of the two accountants. The supervisor's review of their work, which at the time the audit team noticed the inconsistency had not yet been completed, is designed to identify inconsistencies like this, and it most likely would have when performed.

Regarding the second bullet that refers to compiling data from other audited entities to include in the statewide CAFR, this situation refers to a separately audited state entity that gave our office the entity's "draft" audited financial statement to use in our initial compilation process, and then it subsequently provided us its final audited financial statements. There were minor differences between its "draft" and final statements. In managing the financial data we receive from state agencies that are separately audited, our agency maintains an internal control procedure to record any necessary changes between an agency's draft statements, which we sometimes use to accelerate the CAFR compilation process, and an agency's final statements. Before that control was exercised in this instance, the audit team asked us about the minor differences between the agency's final financial statements and its draft financial statements that we used to compile sections of the preliminary CAFR draft. As in the case of the first bullet, our planned review, which had not yet been performed, most likely would have identified the minor adjustments that were needed on our initial draft CAFR.

We do, however, acknowledge that we made a calculation error in our process of implementing GASB 68, and we appreciate that our extensive calculations were subject to your close audit scrutiny.

We appreciate this opportunity to respond to your finding in order to provide this essential detail.

Sincerely,

A handwritten signature in black ink, appearing to read "William E. Gunn". The signature is fluid and cursive, with a prominent initial "W" and a long, sweeping underline.

William E. Gunn
Chief-of-Staff



THE HONORABLE CURTIS M. LOFTIS, JR.
State Treasurer

February 1, 2016

Mr. George L. Kennedy, III, CPA
State Auditor
South Carolina Office of the State Auditor
1401 Main Street
Columbia, South Carolina 29201

Dear Mr. Kennedy

The following is management's response to the 2015-002 financial reporting - reconciliation of cash and cash equivalents – State Treasurer's Office.

1. The State Treasurer has statutory responsibility to ensure that its banking systems balance to the cash balances on deposit in banking institutions.
2. The Comptroller General has statutory responsibility to ensure that the accounting records reflect the cash balances reported by the State Treasurer.
3. The finding confuses these roles since the State Treasurer's Office does not have the statutory or regulatory authority to change the accounting system or accounting procedures.
4. The State Treasurer accounts for the State's cash and investments on a system (STARS) which is separate from the South Carolina Enterprise Information System (SCEIS.) At year end the Treasurer's Office prepares a reporting package to submit to the Comptroller General in order to ensure that actual cash, cash equivalents, and investments balances are properly stated for CAFR reporting purposes.
5. The State Treasurer performs daily, weekly, and monthly reconciliations of bank statement activities to STARS and monthly reconciles STARS to amounts noted within the Comptroller's SCEIS system. Inasmuch as the State Treasurer's reporting package reflects cash balances reconciled between banking institutions and STARS, and STARS has been reconciled to SCEIS, the State Treasurer has confidence that the amounts reported are appropriate for CAFR presentation.
6. The State Treasurer believes the finding to be improper, yet remains committed to the reporting integrity of the finances of the State and will assist in reconciling any variances necessary.

Please feel free to contact me should you have any questions regarding this matter.

Sincerely,

A handwritten signature in blue ink that reads "Tonia L. Morris". The signature is written in a cursive, flowing style.

Tonia L. Morris, CPA
Deputy State Treasurer

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January 29, 2016

Mr. George L. Kennedy, III, CPA
State Auditor
1401 Main Street, Suite 1200
Columbia, South Carolina 29201

Dear Mr. Kennedy:

The South Carolina Department of Social Services respectfully submits the following corrective action plan for the finding identified in the SC Comprehensive Annual Financial Report audit for the fiscal year ending June 30, 2015.

**2015-003 FINANCIAL REPORTING – REPORTING OF LOSS LIABILITIES–
DEPARTMENT OF SOCIAL SERVICES**

Recommendation

We recommend that additional procedures and controls be developed and implemented by DSS to ensure that the financial information provided in reporting packages are reported accurately in accordance with Section 1.7 of the manual referenced above. In addition, we recommend DSS management review their process for reporting the agency's financial information in the reporting packages, to ensure all agency staff preparing and reviewing the reporting packages have adequate knowledge and training to ensure significant financial events are reported in conformity with GAAP.

Response:

Grant Disallowance and Penalties - Loss liabilities relative to the implementation of the Agency's information technology system are calculated from projected expenditures based on the progress of the targeted system completion. DSS Financial Services staff will work more closely with program staff to ensure that information received for future liabilities accurately states what is needed. Additionally, staff will ensure that the information received is appropriately interpreted to determine if it should or should not be included in the grant disallowance report.

If you have any questions regarding this plan, please contact William F. Bray, Jr. at 898-7225.

Sincerely,



Barbara Derrick
Deputy State Director, Administration

January 22, 2016

George L. Kennedy, III, CPA
State Auditor
1401 Main Street
Columbia, SC 29201

RE: Fiscal Year 2015 CAFR
Reporting of Grant Receivables and Unearned Grant Revenue

Dear Mr. Kennedy,

We have reviewed the finding related to the Reporting of Grant Receivables and Unearned Grant Revenue. Please see our response below.

Condition:

"Procedures and controls were inadequate to ensure proper reporting of unearned revenue balances on the agency's grant/contribution revenue reporting package. Balances were reported in the agency's reporting package that did not match the underlying accounting records."

Response:

We agree with the finding. We will emphasize the importance of detailed preparation and review, by the preparer and reviewer, of amounts reported to the Comptroller General's Office for inclusion in the CAFR to ensure the correct amounts are recorded and supported in the accounting records. We will add another step to our variance analysis to ensure all variances are identified.

Sincerely,



Renee D. Herndon
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Office of Administrative Services
(803) 737-5906
Renee.herndon@admin.sc.gov

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