

**SOUTH CAROLINA
OFFICE OF THE ADJUTANT GENERAL**

COLUMBIA, SOUTH CAROLINA

STATE AUDITOR'S REPORT

JUNE 30, 1998 AND 1997

CONTENTS

	<u>PAGE</u>
I. INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES	1
II. ACCOUNTANT'S COMMENTS	
SECTION A - MATERIAL WEAKNESSES AND/OR VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS	5
INTRODUCTORY COMMENTS	6
INTERNAL CONTROL	
Control Environment	7
Risk Assessment	8
Control Activities	9
Information and Communication	9
Monitoring	11
Recommendations	11
REVENUES	
Armory Receipts and Deposits	12
Coding of Revenue	13
Receipts and Supporting Documentation	13
Transaction Numbering	14
EXPENDITURES	
Procurement Code	14
Expenditure Cutoff	15
Allocation of Costs	15
PAYROLL	16
RECONCILIATIONS	17
JOURNAL ENTRIES AND TRANSFERS	19
CLOSING PACKAGES	
All Closing Packages	20
Loans Receivable	21
Cash and Investments	21
Operating Lease and Operating Lessor	22
Accounts Payable	22
Grants and Entitlements	23
Fixed Assets	24
Compensated Absences	25
Recommendations	25

CONTENTS

	<u>PAGE</u>
II. ACCOUNTANT'S COMMENTS (CONTINUED)	
DEFERRED REVENUES	26
UNIT MAINTENANCE FUNDS	
Petty Cash Checking Accounts	26
Contracted Services	27
WORKERS' COMPENSATION	29
TUITION ASSISTANCE PROGRAM	30
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE	32
PUBLIC ASSISTANCE	
Pass-Through Funds	33
Reimbursed Funds	34
COST ALLOCATION PLAN	36
PERMANENT IMPROVEMENT PROJECT ACCOUNTING	39
ACCOUNTING SYSTEM	43
DATA TRANSLATION TO THE STATE	45
SECTION B - STATUS OF PRIOR FINDINGS	48
MANAGEMENT'S RESPONSE	49

INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

December 11, 1998

Major General Stanhope S. Spears
Adjutant General
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 Adjutant General (the Agency), solely to assist you in evaluating the performance of the Agency for the fiscal years ended June 30, 1998 and 1997, in the areas addressed. These engagements to apply agreed-upon procedures were performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The procedures and the associated findings are as follows:

1. We tested selected recorded receipts to determine if these receipts were properly described and classified in the accounting records and internal controls over the tested receipt transactions were adequate. We also tested selected recorded receipts to determine if these receipts were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement. We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law. We compared current year recorded revenues from sources other than State General Fund appropriations to those of the prior year to determine the reasonableness of collected and recorded amounts by revenue account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Revenues, and Public Assistance in the Accountant's Comments section of this report.

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 Agency, and were paid in conformity with State laws and regulations and if internal controls over the tested disbursement transactions were adequate. We also tested selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year. We compared amounts recorded in the general ledger and subsidiary ledgers to various STARS reports to determine if recorded expenditures were in agreement. We compared current year expenditures to those of the prior year to determine the reasonableness of amounts paid and recorded by expenditure account. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Expenditures, and Closing Packages in the Accountant's Comments section of this report.
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; 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; and estimating the fringe benefit expenditures in total and comparing to the actual total to determine the reasonableness of these expenditures. The individual transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control, Payroll, Unit Maintenance Funds, Workers' Compensation, and Cost Allocation Plan in the Accountant's Comments section of this report.
4. We tested judgmentally selected recorded journal entries and all operating transfers and interagency 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. Our findings as a result of these procedures are presented in Journal Entries and Transfers in the Accountant's Comments section of this report.

5. We tested selected entries and monthly totals in the subsidiary records of the 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 tested transactions were adequate. The transactions selected for testing were chosen randomly. Our findings as a result of these procedures are presented in Internal Control and Revenues in the Accountant's Comments section of this report.
6. We obtained all monthly reconciliations prepared by the Agency for the years ended June 30, 1998 and 1997, and tested selected reconciliations of balances in the 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 final reconciliations for fiscal years 1998 and 1997, we recalculated the amounts, agreed the applicable amounts to the 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 Agency's accounting records and/or in STARS. Our findings as a result of these procedures are presented in Internal Control, Reconciliations, Deferred Revenues, Accounting System, and Data Translation to the State in the Accountant's Comments section of this report.
7. We tested the 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 years 1998 and 1997. Our findings as a result of these procedures are presented in Revenues, Expenditures, Payroll, Closing Packages, Workers' Compensation, Public Assistance, Cost Allocation Plan, and Permanent Improvement Project Accounting in the Accountant's Comments section of this report.
8. We reviewed the status of the deficiencies described in the findings reported in the Auditor's Comments section of the State Auditor's Report on the Agency resulting from our engagement for the fiscal year ended June 30, 1996, to determine if adequate corrective action has been taken. Our findings as a result of these procedures are presented in various comments in Section A of the Accountant's Comments as described in Section B - Status of Prior Findings in the Accountant's Comments section of this report.
9. We obtained copies of all closing packages as of and for the years ended June 30, 1998 and 1997, prepared by the Agency 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 Internal Control, Closing Packages, Deferred Revenues, Unit Maintenance Funds, Tuition Assistance Program, Public Assistance, and Permanent Improvement Project Accounting in the Accountant's Comments section of this report.

Major General Stanhope S. Spears
Adjutant General
State of South Carolina
December 11, 1998

10. We obtained copies of the schedule of federal financial assistance for the year ended June 30, 1998, prepared by the Agency 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 did not test the fiscal year 1997 schedule in this engagement because it had been previously audited by us in the State of South Carolina Statewide Single Audit. Our findings as a result of these procedures are presented in Schedule of Federal Financial Assistance, Public Assistance, Cost Allocation Plan, and Data Translation to the State in the Accountant's Comments section of this report.

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 Agency'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 Adjutant General and the management of the South Carolina Office of the Adjutant General 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.

INTRODUCTORY COMMENTS

The entire operations under the South Carolina Adjutant General are very complex, including military operations at both the federal and state levels. Many employees under the Adjutant General's supervision are federal military and/or civilian employees and many of the federal military operations are funded and accounted for by federal agencies. The Adjutant General is also responsible for the South Carolina Office of the Adjutant General (the Agency), a State agency governed by the same State laws, rules, and regulations. The State Auditor's Office is responsible for any required audit functions for the Agency. These functions include an agreed-upon procedures engagement at the agency level as well as the inclusion of the State agency in the Statewide Single Audit and the audit of the State's financial statements.

For fiscal year 1998, the Agency had approximately \$8.2 million appropriations and 62 authorized full-time equivalent positions (FTEs) in general funds and \$29 million appropriations and 195 FTEs in total funds. Most of the difference in general and total funds is federal funding for military operations, maintenance, and construction. In addition to the military operations, the Agency also has an emergency preparedness division.

In our comments that follow we refer to the entity as "the Agency". As such, we are referring to the State agency, South Carolina Office of the Adjutant General and not to all operations under the supervision of the Adjutant General. As necessary, we will mention these other operations and attempt to denote that these areas are not part of the entity to which these engagements apply.

INTERNAL CONTROL

Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. An entity's internal controls are comprised of the following five interrelated components.

1. Control Environment sets the tone of an organization influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. Risk Assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
3. Control Activities are the policies and procedures that help ensure that management's directives are carried out.
4. Information and Communication are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
5. Monitoring is a process that assesses the quality of internal control performance over time.

The following subsections further define the five components of internal control and describe the Agency weaknesses and our recommendations.

Control Environment

As described above the control environment sets the tone of the organization. Factors comprising the control environment include commitment to competence, organizational structure, assignment of authority and responsibility, and human resource policies and practices.

In many ways the Agency's organizational structure is very similar to a military organization. Many of the Agency's key management have a military background which is very useful with respect to the Agency's federal mission. However, the Agency is a State agency and it also requires staff members who are familiar with State government laws, rules, and regulations. As a result of employee turnover, etc., the Agency has lost key personnel who

had a considerable amount of State experience. The loss of State experience has significantly impacted the finance department where familiarity with the State's accounting system (STARS) and State laws, rules and regulations is essential. Also, it does not appear that management has taken steps to ensure that new employees have received adequate training with respect to State requirements. In addition, the Agency has not taken steps to correct the findings reported in the Auditor's Comments section of our agreed-upon procedures report for the year ended June 30, 1996 or findings and questioned costs reported in the Statewide Single Audit Report for the year ended June 30, 1997. As a result, the same or similar comments are repeated throughout this document.

Risk Assessment

An entity's risk assessment for financial reporting purposes is its identification, analysis and management of risks relevant to the preparation of financial statements that are fairly presented in conformity with generally accepted accounting principles. Risks relevant to financial reporting include external and internal events and circumstances that may occur and adversely affect an entities ability to record, process, summarize, and report financial data consistent with the assertions of management (e.g., changes in the operating environment, changes in personnel, etc.).

The Agency's director of budget and finance was terminated in fiscal year 1997. In July 1997 the Agency named an interim director, filling the vacancy internally. The employee was appointed as the permanent director in April 1998. Between July 1997 and December 1998 the Agency had not filled the vacancy created by the internal promotion. During this time the Agency hired temporary employees or contracted with temporary service agencies to fill positions within the budget and finance department. And as stated earlier, because the employees were not familiar with the STARS and State laws, rules, and regulation it impacted the Agency's ability to process and record accounting transactions.

Control Activities

The control activities include operating policies and procedures which are clearly written and communicated. Policies and procedures should address the processing of accounting transactions, physical controls, segregation of duties, and identification of changes in laws, rules, and regulations that affect the agency.

The Comptroller General's Policies and Procedures Manual (STARS Manual) provides guidance to agencies on how to process accounting transactions on the STARS. We determined that the STARS Manual used by budget and finance is not current. As a result, the accounts payable staff has been using outdated object codes to define current accounting transactions that it processes on STARS. In addition, the Agency has decentralized its accounting functions by giving more responsibilities to unit personnel throughout the State, but has not provided unit personnel with resources (e.g., training, equipment, etc.) to perform the additional duties. We also noted that independent reviews of transactions were being performed by employees who reported to the preparer, were being performed by personnel that were not familiar with STARS and other State and federal laws, rules, and regulations, or were just not being performed. This breakdown in controls occurred because of employee turnover in budget and finance.

Information and Communication

Activities relevant to financial reporting objectives consists 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:

1. An accounting system which provides for separate identification and allocation of transactions according to the entity's separate funding sources;
2. Adequate source documentation to support recorded events;
3. A record retention system that ensures compliance with state and federal requirements;
4. Reports that provide managers with timely and useful information; and
5. Reconciliations performed timely to enable timely detection and correction of errors and irregularities.

Based on our observations the Agency's accounting system is not providing users with the information they need to carry out their duties. Internal users do not appear to understand or trust the information provided by the accounting system. As a result, program managers do not use the accounting reports provided by budget and finance. Instead program managers often maintain their own books, usually in a federal reporting format, and completely ignore the books maintained by budget and finance.

The situation described above is most evident in facilities management (FMO). FMO is responsible for construction activities at all Agency facilities. Most FMO employees are employees of the federal government who work in the Agency's headquarters. The Agency's procurement department is also involved with construction projects. We noted that information necessary to ensure proper accountability is not always communicated between FMO, budget and finance, and procurement. For example, we noted open federal grants on the Agency's books which were considered closed by the FMO. We were told that the Agency had not closed them because the accounting records reported negative or positive cash balances in the federal grant accounts.

We also noted that the Agency does not prepare timely account reconciliations. In addition adjustments to record reconciling differences noted during the reconciliation process are not made. As a result, errors which may have a material effect on the accounting records of the Agency and/or State (i.e., STARS) are not detected timely and may go uncorrected. For example, we noted that the Agency did not use the correct project and phase code when it processed certain federal grant transactions. These errors, also affect the State Treasurer's

Office (STO), because the STO uses information from STARS to monitor compliance with the Cash Management Improvement Act.

Monitoring

Management monitors internal controls to ensure that the controls are effective and operating as intended. Effective monitoring procedures include independent checks by managers and supervisors, as well as an active internal audit presence. In fiscal year 1998, the Agency hired a resources manager who was responsible for budget and finance, internal review, and procurement. This employee was given additional responsibilities which prevented her from effectively managing these three areas. In addition turnover in key accounting personnel exacerbated the condition.

We were told that the internal review function was not staffed until January 1999 when one of the two positions was filled internally. Therefore, periodic site reviews of the Guard units have not been performed even though these units have been given more administrative responsibilities during this same period. We are uncertain whether the internal review employee is performing routine quality reviews (i.e., internal audits) of the Agency or is working on special projects. However, if the internal review department is to perform an internal audit function it must be independent of the resources manager and should therefore report to upper level management (e.g., the Adjutant General).

Recommendations

We recommend that the Agency thoroughly review and evaluate its system of internal controls over the entire Agency. It should begin with the control environment as it sets the tone for the entire organization and is the foundation for all other components of internal control. In order to correct the numerous weaknesses and errors detailed in the following comments and maintain the improvements in the future, the Agency must address its control

activities (policies and procedures) to ensure that the Agency is accountable to the State and its grantors. Beyond the organization-wide controls, the Agency must devote significant attention to the information and communication component of internal controls. The accounting system must be accurate and understood by its users. The Agency must improve its reporting to its internal users, the State, and its grantors. Finally, we recommend that the Agency improve its monitoring component of internal control to ensure quality within the Agency.

REVENUES

Armory Receipts and Deposits

The Agency maintains armories throughout the State and rents them to the public for meetings and social functions when they are not needed for military purposes. The armories charge rental fees to cover their costs. As noted for fiscal year 1996, the armories do not deposit receipts timely in accordance with Adjutant General Regulation (AGR) 37-2, Paragraph 1-13.c.(4) which requires all funds received to be deposited by Tuesday of each week. We selected 25 deposit transactions from the population of recorded deposits from fiscal years 1998 and 1997. Of the 50 deposits we tested we found that two 1998 deposits and three 1997 deposits were not deposited in accordance with AGR 37-2. In addition, AGR 37-2, Paragraph 1-13.c.(6) requires each armory to submit all receipt and deposit documentation to the budget and finance department each Tuesday. Of the 50 deposits tested the armories did not timely submit documentation for seven 1998 deposits and five 1997 deposits. Without documentation from the armories, the Agency cannot update and properly reconcile its accounting system with STARS. We were told that the delays resulted from inadequate training and high turnover of armory staff.

We recommend the Agency develop and implement procedures that will ensure that armory receipts are deposited, recorded, and reconciled in accordance with its policies and State laws, rules, and regulations.

Coding of Revenue

The Agency does not use the correct object code to record federal revenues received from other State agencies. The State established revenue object code 2805 – federal grant subcontract state to distinguish these revenues from revenues received directly from the federal government. The Agency did not use object code 2805 in fiscal years 1996 through 1998. Also, the Agency miscoded 2 of 25 deposits tested in fiscal year 1997. It also recorded a refund of utilities as 7201 - miscellaneous revenue instead of a reimbursement of expenditures and recorded a telephone commission as 7403 – rent-state owned property.

We observed that staff in the budget and finance department do not have current excerpts from the STARS Manual section, Definition of Codes. Without proper reference material, training, and supervision, the department cannot be certain that accounting transactions are properly recorded. Therefore, we recommend that all staff responsible for processing accounting transactions receive proper training and maintain a current STARS manual. In addition, we recommend that accounting transactions be reviewed independently before approval to ensure proper coding.

Receipts and Supporting Documentation

In our revenues cutoff test for fiscal year 1998, we noted that the Agency's supporting documentation did not include receipts for 5 of 29 deposits tested. Based on our review of other support documentation we determined that three of the five deposits were recorded in the proper year. However, the documentation for the remaining two deposits was not sufficient to determine if the deposits were recorded in the proper fiscal year.

Transaction Numbering

The SABAR accounting system allows users to manually assign document numbers, however, the system will assign a document number if the field is blank. For fiscal year 1997, the Agency did not consistently post deposit transaction numbers when it entered the transaction in SABAR. As a result, the Agency could not easily provide support documentation for the deposit transactions selected for testing and the Agency was unable to account for the numerical sequence of the deposits.

In fiscal year 1998, the Agency assigned deposit numbers more consistently, however it did not consistently follow its policy of assigning document numbers to each receipt. In addition, the budget and finance department did not prepare receipt documents for some direct deposits and the emergency preparedness division either did not prepare some receipt documents or did not forward the receipt documents to budget and finance.

Sequential numbering of support documents and the periodic accounting of the numerical sequence of support documents are standard internal control procedures. Receipts are typically issued when the funds, especially cash, are remitted in person or when an agency has multiple locations receiving funds. We recommend that the Agency review its current internal control procedures and develop and implement control procedures to strengthen internal controls over cash receipts and revenues. It should also determine if it is effective to assign a deposit and receipt number to each transaction.

EXPENDITURES

Procurement Code

For 2 of 27 vouchers tested for fiscal year 1998, the Agency did not annotate that the “price is fair and reasonable” for purchases of goods or services that cost less than \$1,500 as required by the South Carolina Consolidated Procurement Code (the Code), Section 11-35-

1550.2(a). For fiscal year 1997 we tested 25 vouchers and noted the same violation for 10 of the 25 vouchers tested. We also noted while reviewing a 1997 expenditure that the Agency did not obtain verbal or written quotes for a \$2,157 purchase as required by Section 11-35-1550.2(b).

Expenditure Cutoff

The Agency processed a purchase order to purchase goods/services in June 1996. The goods/services were received in September 1996, however the Agency did not process the voucher for payment until December 1997.

Section 11-35-45 of the South Carolina Code of Laws, as amended states, "All vouchers for payment of purchases of goods or services shall be delivered to the Comptroller General's office within thirty work days from acceptance of the goods or services and proper invoice."

Allocation of Costs

The federal government significantly supports the Agency's telecommunications through the National Guard Military Operations and Maintenance Projects – Appendix 5 – Army National Guard Telecommunications. Appendix 5 describes Federal and State cost sharing requirements (e.g., 96/4, 75/25, 50/50). The cost sharing depends on factors such as the purpose of the telecommunications, the facility where the telecommunications equipment/service is located, etc.

The Agency does not issue purchase orders for recurring telecommunications services. (This procedure is not unusual for a small agency with few service sites and funding from one source.) However, the Agency could not provide documentation to support how it allocated the telecommunications costs. In some cases, the Agency resorted to calling the telephone number to determine its location and based on that location justify the allocation to us.

We recommend that the Agency review its internal control policies and procedures over disbursements and expenditures to ensure that they are adequate in design, properly implemented, and operating effectively. These policies and procedures should also ensure compliance with state and federal laws, rules, and regulations.

PAYROLL

The following were noted in the test of payroll disbursements.

- In fiscal year 1997, the Agency underpaid a terminating employee by \$185 because it misread the time and attendance sheet as to hours worked and leave taken. [We noted a similar problem in our report for fiscal year 1996.]
- For 3 of 25 new hires tested for fiscal year 1998 and 2 of 25 new hires tested for fiscal year 1997, the Agency did not pay the employees on the correct pay date. Most of the errors (one from fiscal year 1998 and both from fiscal year 1997) occurred because the Agency did not timely receive the time and attendance sheets in the budget and finance and human resources departments. Originally, the Agency stated that the remaining two 1998 errors occurred because general ledger accounts had not established in time to process the employees' pay on the correct date. We later determined that one of these employees began work on September 29, 1997 prior to the start of the grant period (October 1) which funded the position.
- In fiscal year 1998, the Agency did not pay a terminating employee for accrued annual leave on the correct pay date.

We are also reporting findings related to temporary grant employees in our comment, Cost Allocation Plan.

An effective system of internal controls includes control procedures to ensure that payroll transactions are correctly valued and properly documented in an employee's payroll or personnel file and errors are detected and corrected in a timely manner. In such a control environment, employees are adequately trained and knowledgeable and independent checks and verifications of performance are included as control procedures.

Proviso 72.19. of the 1997-1998 and 1996-1997 Appropriation Acts continued the established regular schedule for payment of employees beginning with the first fiscal year 1997 pay period of June 2 through June 16 of the prior fiscal year to be paid on July 1 and continuing on a twice-monthly schedule thereafter. The Budget and Control Board is authorized to approve any changes to this schedule where circumstances are deemed justifiable. The Agency did not adhere to the State's payroll period/payday schedule.

We recommend the budget and finance and human resources departments develop and implement procedures to check for clerical accuracy and propriety of the source of funds. These departments should also verify employee pay rates, leave balances, hours worked, termination dates, etc., with supporting documentation in order to ensure that payroll vouchers and employee time and attendance sheets are accurate prior to processing. We also recommend that the Agency comply with the established State pay period schedule and ensure that its new hires do not begin work prior to the availability of funds.

RECONCILIATIONS

Agencies are required to perform cash, revenues, expenditures, and CSA467 report (federal programs) reconciliations between their books and those of the State Comptroller General who maintains the State's books (STARS). For all four types of monthly reconciliations for both fiscal years 1998 and 1997, we noted that the Agency did not adequately document or explain variances between STARS and the Agency's books. The

Agency had a temporary employee preparing the reconciliations much of this time. He primarily identified differences (in total) as opposed to identifying reconciling items. The Agency did not use the reconciliation process as a means to identify and correct errors. We requested explanations for reconciling items as the engagement progressed and as we completed fiscal year 1997 fieldwork in April, 1998. The Agency stated that it would provide us this information within a few weeks. When we returned in September, 1998, to begin the fiscal year 1998 engagement, the Agency still could not provide us with the 1997 information and it never provided us with explanations for fiscal year 1998 reconciling items. We could not determine why the variances existed between STARS and the Agency's books or which books are correct. The Agency did not place an emphasis on controls over reconciliations and therefore it allowed errors to go undetected and uncorrected.

The temporary employee responsible for preparing the reconciliations terminated in December 1998. In our opinion the Agency is not using the reconciliation process to identify and correct errors.

Also for fiscal year 1997 reconciliations, we noted the following control weaknesses:

1. Several expenditure reconciliations were not signed and dated by the reviewer and two were not signed and dated by the preparer or reviewer.
2. Several revenue reconciliations were not signed and dated by the reviewer. Two monthly reconciliations were missing.
3. The cash and CSA467 report reconciliations for the months of July through April were not signed and dated by the preparer or reviewer.

For the fiscal year 1998 reconciliations, we noted the following control weaknesses:

1. Expenditure reconciliations were not dated by the preparer or reviewer.
2. Several revenue reconciliations were not dated by the reviewer. One was not signed or dated by the reviewer.
3. Cash reconciliations were not signed and dated by the preparer or reviewer. They were not prepared on a timely basis. Reconciliations for the months of July through January were dated May 1; February on May 11; March and April reconciliations on May 22; and May, June, and fiscal month 13 in September, 1998.

Section 2.1.7.20 C. of the STARS Manual requires that all agencies perform regular monthly reconciliations between their accounting records and STARS balances shown on STARS reports. These reconciliations must be performed at least monthly on a timely basis, be documented in writing in an easily understandable format with all supporting working papers 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. Errors discovered through the reconciliation process must be promptly corrected in the agency's accounting records and/or in STARS as appropriate.

We recommend the Agency develop and implement procedures to ensure that reconciliations are prepared and reviewed in accordance with State policy and that any reconciling items between its accounting records and STARS are cleared in a timely manner. It should use the reconciliation process as a means for timely detection and correction of errors.

JOURNAL ENTRIES AND TRANSFERS

To test journal entries for the agreed-upon procedures engagements for fiscal years 1998 and 1997, we selected large and unusual entries and limited our test to one entry for the recurring types. As such, we tested few entries involving the master cooperative agreements with the federal government.

For fiscal years 1998 and 1997, we noted that the Agency had missing and duplicated numbers for journal entries in both the physical documents and the posted transactions in the accounting system. The Agency prepares transfer documents using two separate numerical sequences to process transactions with the State, then it enters them in its accounting system with journal entries. We also noted missing and duplicated numbers in the two transfer sequences.

Internal controls over journal entries deteriorated in fiscal year 1998. We observed that supervisors often prepared journal entries and subordinates approved them. Also, we noted that many of the entries were prepared by staff no longer employed at the Agency and that the remaining signer (preparer or reviewer) could not explain the entry.

For internal control to be effective, control procedures must be designed and operating to ensure the propriety and accuracy of recorded transactions and to prevent errors and irregularities. These controls include proper authorization of transactions; segregation of accounting duties; independent checks on performance and on proper valuation and classification of recorded amounts; and preparation and maintenance of adequate documentation.

We recommend that the Agency ensure that its journal entries are prepared and recorded to ensure compliance with all applicable laws, rules, and regulations as well as proper controls. These entries need adequate supporting documentation so they do not need additional explanation and should be prepared by employees sufficiently trained to properly prepare them.

CLOSING PACKAGES

All Closing Packages

The State Comptroller General's Office obtains GAAP (generally accepted accounting principles) data from agency-prepared closing packages for the State's financial statements. We reported findings on eight closing packages in our report on the 1996 engagement. Our review of the closing packages submitted by the Agency for fiscal years 1998 and 1997 also identified findings for eight closing packages as noted in the following subsections. (The findings for 1998 and 1997 usually differed from those in 1996. When findings are similar, we will note that fact in the subsections.)

Section 1.8 of the GAAP Closing Procedures Manual (the Manual) states that each agency is responsible for submitting accurate and complete closing package forms that are completed in accordance with instructions and further states that, “The accuracy of closing package data is extremely important.” Section 1.9 states, “Agencies should keep working papers to support each amount they enter on each closing package form.” In addition, the Manual recommends an effective review of each closing package and the underlying working papers to minimize closing package errors and omissions. To assist each agency in performing effective reviews, the State Comptroller General’s Office requires a reviewer checklist to be completed for each closing package submitted.

Loans Receivable

For fiscal year 1995, the Agency completed a refunds receivable closing package for its tuition assistance program when it should have completed a loans receivable package. It did not complete either package for fiscal year 1996. For fiscal year 1997, the Agency again used the refunds receivable form but used fiscal year 1996 data because the June 30, 1997 data was not available. The Agency used 10% of the outstanding balance as an allowance for doubtful accounts on its 1997 package; however, we noted that 32% of the outstanding balance was due prior to 1990 (seven or more years past due).

Again in fiscal year 1998, the Agency did not complete the loans receivable closing package for its tuition assistance program. The Agency does not have proper internal controls to ensure that it properly and accurately completes all closing packages as required by the Comptroller General. Also, see related findings in the comment, Tuition Assistance Program.

Cash and Investments

Each armory unit of the Agency establishes a local bank account to pay for small nonrecurring purchases. The Agency reimburses each unit upon presentation of paid receipts.

The Agency maintains approximately 80 accounts with a combined maximum agency-authorized balance of \$41,500 for fiscal year 1997 and \$55,650 for fiscal year 1998. Because these are actual bank accounts, the Agency should have reported the book balance of each account at June 30 on the cash and investments closing package. Instead, it reported the agency-authorized maximum balance for each account. We did not determine the amount of the misstatement. See related findings in the comment, Unit Maintenance Funds.

Operating Lease and Operating Lessor

We did not test the operating lease and operating lessor closing packages for fiscal year 1997 because the Agency could not provide us with the closing packages and support documentation. For 1998, the Agency improperly completed the operating lessor closing package. It misstated the total cost of leased property by reporting lease payments instead of the cost of the property. We noted similar errors in the 1996 closing package.

Accounts Payable

We noted in our agreed-upon procedures report for fiscal year 1996 that the Agency used an improper date to determine its contract retention payable and omitted two vouchers from its accounts payable amount. For fiscal years 1998 and 1997, the Agency did not prepare a schedule of accounts payable or document a review of invoices/vouchers that might have been included in the closing package. (The Agency's supporting documentation included only copies of vouchers reported on the closing package.)

The Agency also did not submit forms for all funds for 1997 as required by the Comptroller General. It did not adjust its 1997 grants and entitlements closing package for a federally-funded accounts payable as required. The supporting documentation for the contract retention payable did not adequately support the amount reported. It appears that the Agency included contract retention payables for three projects that had been paid prior to June 30, 1997.

The Agency had not updated its permanent project files in budget and finance during fiscal year 1998. Because these files are used to prepare its accounts payable data, we could not determine the accuracy of the 1998 contract retention payable.

We tested a petty cash reimbursement to one of the Agency's unit maintenance funds which was charged to July, 1998 (fiscal year 1999). The reimbursement included an expenditure from April (fiscal year 1998). The Agency did not include this amount in its accounts payable closing package. Also, the unit violated Adjutant General Regulation 37-2, Paragraph 1-13.a., which states "At the close-out of the State fiscal year 30 June, all invoices not reimbursed must be submitted to TAG-DSO-BF for processing." This regulation is intended to ensure a proper cutoff of expenditures for the fiscal year.

Grants and Entitlements

Because of the timing of our engagements and the closing package due dates, we tested the 1995 grants and entitlements closing package in our 1996 engagement. (We did not test the 1996 package because the Agency submitted it late for the 1996 engagement, and we skipped to the 1997 package for our 1997 engagement.) The Agency did not prepare the required grants analysis worksheet for fiscal years 1995 and 1997. As noted above, it did not adjust these closing packages in 1997 or 1998 for accounts payable as required.

For fiscal year 1997, the Agency overstated grants and entitlements deferred revenue for GAAP fund 2005 by approximately \$47,000 because it reported amounts funded by cabin rentals instead of grants and contracts. For fiscal year 1998's permanent improvements form, the Agency reported over \$33,000 that should not have been on any of the grants and entitlements forms.

The grants and entitlements closing package requires separate forms for permanent improvements and for grants funding operations. The Agency did not separately report permanent improvements for fiscal years 1997 and did not accurately separate them for 1998.

Therefore, the Agency misclassified amounts between funds 2005 and 4005 on the governmental funds form and funds 2005, 2007, and 2060 on the permanent improvements form by approximately \$816,000 and \$1,000,000 in fiscal years 1998 and 1997, respectively. Also, because the Agency's schedules of federal financial assistance for fiscal years 1998 and 1997 contained errors and it used them to prepare the closing packages, we noted additional errors in these closing packages. See related findings in the comment, Schedule of Federal Financial Assistance.

Fixed Assets

We did not test the 1996 fixed assets closing package during our fiscal year 1996 engagement because the Agency submitted it late to the Comptroller General and it was not available at the time of our fieldwork. For fiscal year 1997, the Agency reported approximately \$1,695,000 more equipment on its closing package than its fixed asset active detail master report. Agency personnel could not provide adequate support for many of the individual amounts reported on the closing package. We noted inconsistencies in capitalizing equipment — some items over \$1,000 (capitalization limit) were not capitalized and some items less than \$1,000 were capitalized. The Agency recorded some items to supplies and telephone expenditure object codes (non-capital) but then capitalized them as equipment.

For fiscal year 1998, we could not obtain supporting documentation for the fixed assets closing package during the agreed-upon procedures fieldwork; however, the Statewide Single Audit staff obtained the information and noted the following errors. The Agency reported on its closing package approximately \$1,517,000 more equipment than its fixed asset active detail master report. For 2 of 18 equipment vouchers greater than \$5,000 that we tested, the Agency improperly omitted them as equipment on its master report. Also, it added items to its list based on purchase order date. As a result, we noted four items ordered on or before June 30 but not received until after June 30 improperly included on its fiscal year 1998 master report.

For fiscal years 1998 and 1997, the Agency could not support its current year depreciation amount reported for GAAP fund 7204. For 1998, it erroneously reported the current year depreciation amount in the net corrections to prior year balances column.

Compensated Absences

We judgmentally selected 10 employees from the Agency's leave liability – all types report to verify the leave liability reported on the closing package. We noted one employee with a holiday compensatory time balance that consisted of compensatory time earned in 1995 and 1996. As of June 30, 1998, the employee still had not used this leave. Per State Human Resources Regulations 19-703.06 C.4. (dated July 1, 1996), the holiday compensatory leave credits must be used within ninety calendar days.

Recommendations

We recommend that the Agency develop and implement procedures to ensure that its financial information is properly identified and that its accumulated balances and transactions are reported in accordance with generally accepted accounting principles (GAAP) and GAAP Closing Procedures Manual (Manual) instructions. These controls should cover any information processed through STARS, closing packages, and the Agency's accounting records. The Agency should retain supporting workpapers and file them in a manner in which they can be readily retrieved. The Agency should ensure that all closing package forms and supporting workpapers are completed and reviewed in accordance with the Manual requirements and guidance by employees who have been properly trained to prepare and review them.

DEFERRED REVENUES

For fiscal year 1996, we noted that the Agency did not record revenues received but not earned until future periods as deferred revenues on its or the State's books as required by Section 3.2.2.1 of the STARS Manual. In fiscal year 1997, the Agency recorded deferred revenue in the State's books, but it recorded the transaction as ordinary revenue in its books. To agree the Agency's books to the State's books, we had to add the revenue and deferred revenue accounts on the State's books and agree the sum of those accounts to the revenue accounts on the Agency's books.

In fiscal year 1998, the Agency reversed the June 30, 1997 deferred revenues on the State's books. It recorded current deferrals in a separate revenue account on its books and in the deferred revenue account on the State's books. The Agency's accounting system allows for liability accounts, but it has not used the system to properly account for these transactions in accordance with generally accepted accounting principles (GAAP) or the State's instructions.

We recommend that the Agency fully utilize its accounting system and properly account for deferred revenue. We further recommend that the Agency train its employees in the preparation and review of receipts and deposits to ensure proper procedures and accurate coding in accordance with both the State's accounting practices and GAAP.

UNIT MAINTENANCE FUNDS

Petty Cash Checking Accounts

The Agency maintains approximately 80 armory units across the State. It receives a line-item State general fund appropriation of approximately \$1.3 million to fund these armories. The Agency expends a small portion directly from that line item. The remainder is recorded as an expenditure from the State General Fund and as a revenue to the 3174 earmarked subfund. Each unit across the State opens a bank account in its name and operates it as a

petty cash checking account. The units periodically request reimbursement from the 3174 subfund to replenish their bank accounts.

The supporting document provided by the Agency for the cash and investments closing package listed the imprest amount for each unit. For fiscal year 1997, all accounts had a \$500 amount. This was the agency-authorized maximum amount for these accounts. For 1998, many of the accounts still have a \$500 amount, but we noted 21 accounts had balances greater than \$500, including a maintenance unit in Orangeburg that had a \$3,700 balance. The Agency violated its own policy and State law by authorizing amounts greater than \$500 and not obtaining the State Auditor's Office approval to increase these accounts.

Adjutant General Regulation 37-2, Paragraph 1-13.a. states, "Authorization to open a bank checking account must be requested in writing to TAG-DSO and approved by the South Carolina State Treasurer's Office and State Auditor's Office..." and Paragraph 1-13.b. states "Each Armory Fund Custodian shall be allocated \$500." The only exception given for a higher amount is for bank accounts that impose banking fees for accounts with a minimum \$200 balance. State law requires agencies to obtain State Treasurer approval for bank accounts and State Auditor approval for petty cash accounts.

Contracted Services

Adjutant General Regulation (AGR) 37-2 is titled Financial Administration of Armory Operations Fund and was effective September 1, 1997. It superseded all portions of AGR 37-4 pertaining to Armory Operation Funds. AGR 37-2, Paragraph 1-7. is titled Employment of Personnel on the contents page and in the text is titled Contract Services. AGR 37-4 states that employment of personnel in support of the rental program shall be processed by the State Human Resource Office as contract employees. We noted that in fiscal year 1997 armory sitters had been processed though the Agency's payroll.

In fiscal year 1998, the Agency began paying its sitters from the unit maintenance fund bank accounts and charging this expenditure to a contractual services object code when the bank account was replenished. The basis for the change is the new regulation AGR 37-2, Paragraph 1-7. which requires the armory manager to “contract” this service by establishing a rotating roster of available responsible full-time and traditional National Guard personnel and further describes four concepts to avoid conflicts with the Internal Revenue Service (IRS) regulations.

A note to AGR 37-2, Paragraph 1-7. states, “The IRS considers the difference between a contract service (no tax withholding required) and an employee (tax withholding required) is: providing direct supervision while the task is being performed, the establishment of fixed reoccurring hours, and providing the tools and supplies of the trade.” The note to AGR 37-2 further instructs the armory manager to file a 1099 with the IRS for individuals receiving \$600 or more during a calendar year.

The Agency amended these regulations for the purpose of avoiding the requirement to process armory sitter expenditures through payroll. In so doing, we believe it circumvented IRS regulations regarding employees versus contracted services. In our opinion, the Agency did not establish a true contracted service; the sitters are Agency employees. Therefore, the Agency has violated IRS regulations by not including all pay on a W-2 and erroneously reporting only amounts over \$600 on a 1099. Because these amounts should have been reported as payroll, the Agency is in violation of IRS regulations for not withholding and timely depositing payroll taxes. The Agency also violated State law requiring all payroll to be processed through the State Comptroller General. Also, AGR 37-2 requires the armory manager to forward a copy of the 1099 forms to the Agency’s human resource (HR) department. In late January 1999, we requested copies of these forms from HR for calendar years 1997 and 1998 and received one 1096 form (the transmittal form for 1099s) and one

1099 form for 1997 and none for 1998. We noted that the Agency improperly completed the 1096 form and submitted it late.

AGR 37-2, Paragraph 1-7.b. states, in part, "... Contracting of grass cutting services may continue if it is determined ... to be more cost effective than cutting grass by unit personnel." In our test of the 1998 accounts payable closing package, we tested a unit maintenance fund account reimbursement voucher that included grass-cutting services. The support did not include the person's social security number or IRS employer identification number. We did not determine if this transaction was of an employee or contractual nature, but it does not appear that the armory would capture this transaction as subject to 1099 reporting.

We recommend that the Agency review AGR 37-2 for compliance with all federal and state compliance requirements. Those assigned to perform this review should be familiar with federal (military and Internal Revenue Service) and state laws, rules, and regulations. For any areas deemed in violation, we recommend the Agency establish and implement policies and procedures to prevent future violations and that it meet with appropriate federal and state agencies to determine if it is liable for any fines or penalties related to previous violations.

WORKERS' COMPENSATION

In fiscal years 1997 and 1996, the Agency paid approximately \$341,000 and \$170,000, respectively, in workers' compensation premiums. In fiscal year 1998 the Agency expended \$33. The Agency did not allocate the premiums to general, earmarked, and federal funds; instead it charged 100% of the premiums to the general fund. We were told that the reduction in the worker compensation premium between fiscal years 1998 and 1997 occurred because the Agency received a five year credit as a result of overpayments made in prior years. It appears that the Agency reported federal National Guard active duty expenditures which are not covered by the State's workers' compensation policy.

The worker's compensation premium is based on personal service expenditures. As a result, the Agency should have allocated the premium based on the each fund's personal service costs.

Section 17F.1. of the 1997-98 Appropriation Act, states in part, "... 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 ..."

We recommend that for each fiscal year the Agency allocate workers' compensation premiums or refunds among funds based on the funds' proportionate share of payroll. It should obtain and file information related to billings, credits, and payments in a manner that can be easily retrieved to support workers' compensation coverage and expenditures. It should maintain supporting documentation for all billings even if they did not result in expenditures due to credits received and applied.

Also, we recommend that the Agency determine how long other funds' have not paid their share of the cost and seek reimbursement as appropriate. If, as it appears, the credit the Agency received applied only to premiums paid by the State General Fund, then during the period the credit is being applied the other funds should be charged their share of current costs and remit them to the State General Fund. Any prior year recoveries and current costs charged to earmarked and federal funds during the period in which the credit is applied should be remitted to the State General Fund as refunds of prior years' expenditures.

TUITION ASSISTANCE PROGRAM

The Agency is not maintaining and monitoring accounting documentation for its tuition assistance program. Prior to August, 1995, the South Carolina National Guard awarded tuition assistance program scholarships to qualified college students. The program regulations

stipulated that, if the recipient does not complete a two-year service obligation, the recipient must reimburse the Agency the total amount of the scholarship. The State provides funding for this program from its general fund. The Agency did not receive funding and did not award scholarships in fiscal years 1997 and 1996. In fiscal year 1998, the Agency again received funding and awarded scholarships.

As noted in our prior report, the Agency did not monitor or update the program's receivables during fiscal year 1996. As reported in our comment, Closing Packages – Loans Receivable, the Agency reported fiscal year 1996 data when it reported its fiscal year 1997 receivables to the State Comptroller General. It did not report these loans receivable, as required, to the State for fiscal year 1998.

The Adjutant General has delegated his responsibility for the agency's tuition assistance program to federal employees under his control. The Agency's responsibility after the assistance is paid to the Guard member has been limited to the preparation of the closing package which it submits to the State Comptroller General. The Agency informed us that the monitoring and updating is not performed by employees trained in budgetary or GAAP-based accounting.

It appears that the receivables are rarely collected by the Agency. In fiscal years 1999 and 1998, the federal employees referred to above attempted to collect past due receivables and considered requesting approval from the South Carolina Department of Revenue to have these delinquent accounts recovered through its refund offset program.

Adequate accounting control requires transactions to be properly classified by account and accounting period and properly valued; receivables monitored; collection plans implemented; and accounts updated in a timely manner as scholarship recipients meet their service obligations or payments on the outstanding balances are received.

We recommend the Agency develop and implement procedures to ensure that the program is operating effectively, tuition assistance transactions are properly accounted for on the Agency's books, and that appropriate steps are taken to collect reimbursement from individuals who do not meet their enlistment obligation.

SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE

The State Auditor's Office prepares the State's schedule of expenditures of federal awards (SEFA) from agency-prepared schedules of federal financial assistance (SFFA). The SEFA is the primary financial statement audited in the Statewide Single Audit. The Agency receives funding from two programs which we audited as major programs in the Statewide Single Audit for fiscal years 1998 and 1997.

The Agency submitted its 1996 SFFA to the State Auditor's Office late. The schedule was not tested in the agreed-upon procedures engagement, but it was tested in the 1996 Statewide Single Audit. The fieldwork for the 1997 Statewide Single Audit was performed prior to the agreed-upon procedures for the same year; therefore, the SFFA was tested only in the Single Audit. For fiscal year 1998, we tested the SFFA in both 1998 engagements (at different levels of detail).

For fiscal years 1998 and 1997, we noted numerous errors in the schedules. The Agency reported a different grant for each fiscal year in CFDA program 12.400 which should have been reported as 12.401. (Both 12.400 and 12.401 are major programs to the State.) The Agency reported several program names and numbers, grant names and numbers, and project/phase code numbers incorrectly. The 12.401 program is reported to the federal government per agreement appendix. The federal fiscal year and appendix number are easily identifiable fields in the federal grant number. We noted several errors in these numbers on the schedule; thereby making our Statewide Single Audit schedules incorrect.

We corrected 1997 known errors in the schedule, but we determined the 1998 errors were too extensive to correct. In our opinion, the breakdown in controls over various other transactions cycles also led to errors in the Agency's SFFA.

We recommend the Agency establish policies and procedures to ensure that the schedule is accurate; complete; prepared and reviewed by trained personnel; and supported by its accounting system and grant files. The Agency should carefully read and follow instructions from the State Auditor's Office.

PUBLIC ASSISTANCE

Pass-Through Funds

The Agency established two subfunds to account for public assistance funds (federal grant pass-through funds) received from the Federal Emergency Management Agency (FEMA). FEMA allows only one agency per state to draw funds for the entire state. In South Carolina, the designated agency is the South Carolina Office of Adjutant General (the Agency). When the Agency receives these funds, it passes them to the Governor's Office which distributes the funds to State agencies and other public and private entities and individuals who qualify for assistance. (The Agency also qualifies to receive these funds as noted below. When it receives them, it goes through the same process by drawing the funds from FEMA, passing them to the Governor's Office, and receiving its share back from the Governor's Office.)

For these pass-through funds, the Agency established subfund 5544 in fiscal year 1998 for hurricane relief and subfund 5903 several years ago for flood relief. It records funds drawn from FEMA as credits to federal grant revenues and funds passed to the Governor's Office as debits to federal grant revenues. These subfunds translate to a governmental GAAP fund code in the State's GAAP-basis accounting system but should translate to an agency GAAP

fund code. Section 3.3, page 8 of the GAAP Closing Procedures Manual states, "GAAP requires that the State use Agency Funds to account for any grant/entitlement funds that one agency will pass through to other State agencies ... Accordingly, the Comptroller General's Office asks that agencies establish and use separate STARS subfunds for grants/entitlements they will pass through to other State agencies."

During fiscal year 1998, the Agency did not consistently use its two public assistance subfunds. If the Agency had used these subfunds as it intended, federal grant revenues would have netted to zero for each subfund at fiscal year end. It appears the Agency recorded revenue received in the proper subfund; however, it transferred to the Governor's Office approximately \$49,000 out of subfund 5542 instead of 5903, leaving subfund 5542 with a deficit revenue balance of approximately \$49,000. This error and approximately \$14,000 in ending cash balance created an ending balance of approximately \$63,000 in subfund 5903 federal grant revenues.

We recommend the Agency implement procedures to ensure adherence to both the State's accounting practices and GAAP regarding the establishment of subfunds in STARS and the GAAP funds to which they translate, the proper use of object codes especially if these subfunds are reclassified to agency funds, and the timeliness and accuracy of clearing pass-through funds.

Reimbursed Funds

As noted above, the Agency receives FEMA funds as reimbursement for its expenditures (both direct and indirect expenditures). In July, 1996, the Agency received \$339,412 from FEMA for administrative (indirect) costs related to Hurricane Hugo. The Agency should have remitted these funds to the State General Fund but instead it expended these funds in fiscal years 1998 and 1997 for its own use, mainly for equipment and automation.

Near the end of fiscal year 1997, the Agency incurred approximately \$852,000 in costs related to Hurricane Fran and received a supplemental appropriation to cover 100% of these costs. In July, 1997 (fiscal year 1998), FEMA reimbursed the agency approximately \$657,000, which included 75% of the direct costs (FEMA's share) and approximately \$18,000 for administrative costs. As of December 1998 (eighteen months after it drew the funds), the Agency had not remitted any of these funds to the State General Fund and had spent approximately \$5,800 of these funds. The Agency stated that it believed it could keep the administrative funds and that it was unsure of the process to remit the other funds. The Agency does not equate administrative costs to indirect costs; therefore, it assumes that it can retain these funds.

Section 2-65-70.(A) of the 1976 South Carolina Code of Laws, as amended, states in part, "All indirect cost recoveries must be credited to the general fund of the State, with the exception of recoveries from research and student aid grants and contracts." Code Section 11-9-125 states, "Federal and other funds must be expended before funds appropriated from the general fund of the State, to the extent possible, and any excess balances in accounts resulting from matching fund programs must be remitted to the general fund of the State. Federal or other funds generated by the expenditure of state funds, including refunds from prior year general fund expenditures, must be remitted to the general fund of the State if there is no federal or state requirement governing the specific use of the funds ..."

We recommend that the Agency remit all indirect costs to the State General Fund, regardless of the terminology used such as administrative costs or cost allocation plans, in accordance with Section 2-65-70. Also, we recommend that it remit to the State General Fund the direct reimbursement related to Hurricane Fran as reimbursement of prior year's expenditures. We recommend that the Agency train its employees in the proper treatment of direct and indirect reimbursement of grant funds and that it ensure timely cash management of all such funds.

COST ALLOCATION PLAN

The National Guard Bureau which administers the Agency's two major military federal programs does not allow indirect costs for its military construction program or for its military operations and maintenance projects program except as part of an approved cost allocation plan (CAP). Prior to fiscal year 1997, the Agency did not have a CAP; therefore, it did not charge indirect costs to these two military federal programs. It did charge indirect costs to its emergency preparedness division's (EPD) grants and remitted these costs to the State General Fund.

For fiscal years 1998 and 1997, the Agency established a CAP for its military operations and maintenance projects program. For fiscal year 1997, the United States Property Fiscal Officer (USPFO) assigned one of its employees to the Agency to prepare the CAP. The USPFO approved the CAP for the federal government. This same USPFO employee who is now employed by the Agency prepared the updated CAP for fiscal years 1999 and 1998. Agency personnel did not provide us with documentation to support the approved CAP. The Agency did provide us with some preliminary information, but we determined that the information differed from that in the approved CAP.

Because we were unable to audit the information supporting the CAP we questioned all CAP costs in the Statewide Single Audit for the year ended June 30, 1998 related to fiscal years 1998 and 1997 (\$358,089 - 1998 and \$165,347 - 1997). Even though we could not audit the CAP, we did note the following errors with the plan and its implementation:

1. In its general ledger and its schedule of federal financial assistance (SFFA), the Agency is reporting all CAP costs in its military operation and maintenance projects program (12.401 program) even though the CAP includes some emergency preparedness division (EPD) grants from other federal programs.
2. Because the Agency is charging these other EPD grants under both the CAP and the indirect cost agreement, it is double charging these other grants.
3. The Agency is charging at least one employee directly to the 12.401 program and then indirectly charging a significant portion of her costs through the CAP.

4. Because the Agency stated that it believes CAP costs are not indirect costs, it has not remitted them to the State General Fund as required for indirect costs.
5. The Agency retains the CAP costs and is funding the hiring, particularly in fiscal year 1999, of employees as temporary grant employees. It is also using these funds for management consultants to assist in the procurement of a federal contract.
6. In hiring these temporary grant employees, the Agency is filling positions of a temporary and grant-specific nature as well as of a permanent and organization-wide, such as the resources manager over budget and finance, procurement, and internal review. It is also improperly gaining approval from the Office of State Budget for these temporary grant employees by improperly stating that they are working on specific grants.
7. The Agency did not seek the State's approval of the CAP and did not follow State laws, rules, and regulations in developing the CAP. The CAP does not include an allocation of central State services from the Statewide CAP.

The 1976 South Carolina Code of Laws, as amended, in Section 2-65-70 (A)(1) requires the recoveries of indirect costs, either through an approved indirect cost rate or cost allocation plan. Also, allowable cost/cost principles is one of the fourteen compliance requirements identified and described in the OMB Circular A-133 Compliance Supplement. Therefore, we are required by both state and federal requirements to audit the Agency's CAP.

Code Section 2-65-70 (A)(1) further states "Agencies shall prepare the indirect cost proposals and submit them to the board (State Budget and Control Board) for review. The board shall submit the proposals to the appropriate federal agencies, negotiate the agreements, and transmit approved agreements to the state agencies. ..." Code Section 2-65-70 (A)(2) states, "The board annually shall prepare the Statewide Cost Allocation Plan for allocation of central service costs to federal and other programs. The board shall ensure that state agencies recover costs approved in the plan through federal grants and contracts, subject to federal laws and regulations." The Agency did not seek Board approval for its CAP and did not include an allocation of central service costs for the State.

Part 3. B. of the OMB Circular A-133 Compliance Supplement states in part, "CAPs ... usually are prepared on a prospective basis using actual financial data for a prior year or budget data for the current year. When the actual costs for the year covered by the CAP ...

are determined, the difference between the costs recovered based on the CAP ... and the costs that would have been recovered had the CAP ... been based on actual results is ... carried forward to a subsequent CAP..., with the approval of the Federal cognizant agency for indirect cost negotiation.” The Agency did not determine the differences as required and carry them forward to its CAP for fiscal years 1999 or 1998.

We recommend that the Agency remit all costs recovered through the CAP to the State General Fund as required and refund to the federal grantor any indirect costs charged on grants which the Agency also included in the CAP. We further recommend that the Agency correct the errors in its CAP for fiscal year 1997 forward and obtain the required approvals from the State for its CAP.

The Agency should seek permanent positions for its employees who perform duties of a permanent and organization-wide nature instead of using “temporary grant positions”. If the Agency had the positions for employees who are included in the CAP established as State General Fund positions and received appropriations for these positions, then the State would recover these costs through the indirect costs the Agency remitted. The Agency with the State’s approval may determine an alternative manner in which to accomplish the accounting for CAP costs and recoveries. However, the Agency should not provide incorrect information to obtain approval for temporary grant employees.

We recommend that the Agency establish, implement, and monitor policies and procedures which will ensure that the CAP is completed accurately, including roll-forward adjustments for the difference in actual costs and the costs used in the CAP, and is prepared and reviewed by employees trained in both federal and state requirements for a CAP. The CAP should be prepared accurately using data from its accounting system and other reliable sources and in accordance with applicable cost principles; properly supported with records retained for audit; and reviewed by a trained, independent employee to ensure accuracy, consistency, and proper Agency authority.

PERMANENT IMPROVEMENT PROJECT ACCOUNTING

The Agency receives most of its federal funding from the United States Department of Defense for two major programs: military operation and maintenance projects and military construction. During the 1998 Statewide Single Audit, we noted several errors related to the test of matching for military construction. That audit addressed only federal non-compliance; however, we noted more significant non-compliance related to state accounting rules and regulations and Statewide Permanent Improvement Reporting System (SPIRS) requirements which we will report below.

As noted in our comment, Internal Control - Information and Communication, internal controls over construction activities are extremely weak and risks are high due to a lack of communication between budget and finance, procurement, and facilities management. The Agency has a high number of errors and compliance violations involving SPIRS projects and a slow error correction rate due mainly to the decentralization of construction activities. The Agency has not made a clear division of responsibilities between the departments and has not recognized that its staff is inadequately trained to properly account for these projects.

We noted that the Agency established a statewide project for underground storage tank (UST) removal/replacement but also established projects for each individual tank. It reported the expenditures by individual project, but did not close the statewide project. Also, we noted that the Agency reported the budget balance (budget less expenditures) from the State's SPIRS report as the outstanding commitments on its fixed assets closing package. The budget balance includes recently-established projects for which no commitments have been made and also includes the \$450,000 as noted above for the statewide UST project which should be closed.

For armory construction projects funded with military construction funds, the State must provide a match of 25% of the total costs for armory construction projects that occur on State property. The Agency receives capital improvement bond (CIB) proceeds from the State for this match.

For the Gaffney armory construction, the Agency received a federal budget increase of \$26,490 from the National Guard Bureau (NGB) in March, 1996; however, it did not process the increase through SPIRS. At June 30 and still at November 30, 1998, the project was over expended in total by \$16,942. Upon further investigation, we determined that the project actually exceeded its budget in October, 1997, and the State Budget and Control Board – General Services had notified the Agency then and again on January 8, 1999 to resolve the problem. After a second request from General Services, the Agency submitted an A-1 (SPIRS form) to increase the federal budget by the \$26,490 on January 15, 1999. We did not determine why the oversight in processing the request occurred.

At June 30, 1998, and after consideration of the \$26,490 federal budget increase, the Agency's budget balance for the project in total was \$9,549. The Agency's CIB-funded budget balance was \$11,890. Therefore, the Agency had still exceeded the federal budget for the project by \$2,341 (total budget balance of \$9,549 less the CIB budget balance of \$11,890). We also noted that the CIB budget balance did not agree to the CIB proceeds left to draw of \$14,590 per the State Treasurer's Office Debt Management System (STODMS) by a difference of \$2,700 due to an expenditure made to the City of Gaffney in October 1997. As of December 31, 1998, the Agency had not made a CIB draw to cover this expenditure.

Also as noted in our Statewide Single Audit report, the Agency expended \$107,487 as partial payment of a mediation settlement for the Pickens, Ware Shoals and Fountain Inn armories. It paid the \$107,487 entirely from the Pickens' CIB fund rather than prorating the expenditure between each of the three projects' federal (75%) and CIB (25%) funds. At December 31, 1998, the Agency had not corrected this error.

According to budget and finance (BF) as well as the facilities management officer (FMO), the Agency paid the voucher as such due to a lack of funds for each project. Our review of the permanent improvement program summary (a SPIRS report) at June 30, 1998, determined that the total budget balance for each of the three armories was sufficient to pay its share of the voucher.

Upon further investigation, we determined the problem to be in the budget balance per source of funds (federal or CIB). We noted that CIB draws and related expenditures were materially equal for Ware Shoals and Pickens (including the \$107,487 erroneously charged entirely to Pickens). However for the Fountain Inn armory, the Agency had drawn the entire authorized CIB amount of \$763,800 but had only reported \$597,481 in related CIB-funded expenditures.

Based upon research and inquiries with BF and FMO, we determined that the Agency incurred expenditures in 1994 on the Pine Ridge Armory for which it did not have a sufficient budget. It originally charged these expenditures to Fountain Inn CIB fund and drew Fountain Inn CIB proceeds. Subsequently, both the expenditures and CIB draw were reclassified to the Pine Ridge CIB fund on the Agency's books but not on SPIRS. In so doing, the Agency intentionally drew and expended \$168,574 of CIB funds authorized for Fountain Inn on its Pine Ridge armory without State approval. FMO stated that the Agency believed additional State funds were going to be awarded for Pine Ridge and that the funds it "borrowed" from Fountain Inn for Pine Ridge could be repaid. These extra funds never materialized for Pine Ridge, and now Fountain Inn is short of funds and is "borrowing" from Pickens. In effect, the Agency has created a situation in which it continuously completes one project from a subsequent project's source of funds. We believe this practice might date back even further than 1994.

Section 2-47-35 of the 1976 South Carolina Code of Laws, as amended, specifies that no project authorized for any capital improvement bond funding can be implemented until

funds are made available and describes an authorization and approval process for scope, budget, and funding changes. Part I, Chapter 4 of the State's Manual for Planning and Execution of State Permanent Improvements (SPIRS Manual) states that when an agency requests transferring funds between projects, it should ensure that sufficient funds remain in the project from which the funds are to be transferred. However, the procedures here relate to transferring balances of projects nearing or at completion instead of transfers from new projects to complete old projects. Both the Code and the STARS Manual specify responsibilities of the Board and Control Board, Joint Bond Review Committee, and the General Assembly. However, the Agency did not inform oversight agencies or seek approval for its actions.

We recommend the Agency establish policies and procedures to ensure all permanent improvement project funds are expended and accounted for in accordance with state and federal laws, rules, and regulations. To ensure that its projects are not over budget, we recommend that the Agency monitor each project's budget by funding source, reconcile its books to SPIRS and STODMS and reconcile CIB draws and expenditures between SPIRS and STODMS. It should not commit by funding source or in total to expenditures without sufficient, authorized funding. We recommend that the Agency monitor its cash balances in the various funds for its SPIRS projects to ensure that CIB and federal grant draws are made timely and in accordance with federal and state requirements.

We further recommend that the Agency review its organizational structure and take other measures necessary to increase trust and cooperation among its departments, clearly delineate the responsibilities of each department, and adequately train its employees. The Agency should consider its accounting system to be the official source for any internal or external accounting, budgeting, and financial information. It should eliminate duplicate sets of books and spreadsheets created because of this lack of trust. When federal military and state

agency requirements make specialized reporting necessary, the Agency's books should be used or specialized reports should be supported by and reconciled to the Agency's books.

Also, we recommend that the Agency cease funding the completion of one project with a new project's funding and correct errors which have already occurred. The Agency should charge expenditures to and draw funds from the proper project and also inform and seek necessary approval for all transfers in funding for its SPIRS projects. Finally, we recommend that the Agency correct its and the State's books for projects over budget by funding source, for transactions made without proper authority and for use of improper accounts.

ACCOUNTING SYSTEM

The Agency uses the SABAR accounting system, which is used by several other State agencies. We noted that the Agency does not use SABAR as it was designed to the extent that it did not effectively and efficiently report accurate information to management or other users.

The Agency has not utilized the budgeting component of its accounting system for several years. Neither budget and finance nor program managers can effectively monitor budgets. We noted that some managers designed spreadsheets for their own use because either the managers received information which was inaccurate or in an unusable form or they did not understand the information they received.

When agencies have grants and permanent improvement projects, they must maintain balances over the life of the project, not just by fiscal year. Therefore, accounting systems are designed so that prior year balances can be brought forward. We noted that the Agency was very inconsistent in accounting for carry forward balances (i.e., the Agency brought forward some account balances, overlooked others, and made opening balance adjustments directly to the carried-forward amount). The Agency did not use an automatic roll forward function of its

accounting system, instead it manually posted roll-forward balances. This process increases the risk that errors will occur especially when employees who are unfamiliar with STARS and GAAP requirements make these decisions and perform these processes.

We also noted the Agency's federal financial reports did not agree to the Agency's books. Because the Agency did not timely correct errors in its accounting system and maintain project accounting data (i.e., cumulative expenditures), it maintained separate spreadsheets to accumulate information and make changes to the data prior to submission of the federal financial reports.

An agency should have an adequate accounting system in compliance with state and federal requirements as well as GAAP. As noted in the comment, Internal Control, one of the five components of internal controls is information and communication. Accurate information in a usable format should be available to all users.

Finally, we noted that the Agency backs up the SABAR system tapes daily and stores them on its premises in a locked filing cabinet. It informed us that a fireproof safe was ordered to store the tapes. However, the Agency does not have an off-site storage plan and has not developed or tested a contingency plan in the event of loss or interruption of the accounting system. To ensure the continuity of financial operations the Agency should develop a contingency plan to protect it in the event of a catastrophic loss.

We recommend that the Agency provide its accounting staff with training so it can maximize the use of its accounting system to properly account for all funds and accounts, particularly for grants, permanent improvements, and budgets. The Agency should consider using the automatic roll-forward feature to reduce the risk of error and ensure that corrections to beginning balances are not made without a proper audit trail, i.e., prior year balances are not changed in the current year without making opening balance adjustments.

We further recommend that the Agency establish policies and procedures to ensure that the Agency's accounting system will serve as its official source of financial information and that its internal users understand and trust the system. The Agency should prepare its federal financial reports from its accounting system. If corrections or accumulation of accounts are necessary, the Agency should document these and promptly make any necessary corrections to the accounting system which it discovers while preparing the federal financial reports. Also, we recommend that the Agency develop and test a contingency plan to ensure that its accounting system will be available to all users in the event of loss or interruption. The plan should include both on-site and off-site storage of back-up tapes of the SABAR system.

DATA TRANSLATION TO THE STATE

The State maintains two accounting systems: STARS which is its budgetary accounting system and Series Z which is its GAAP-basis accounting system. Agencies are required to submit all revenue and expenditure transactions to the State's Comptroller General to be processed in STARS and are required to reconcile their books to STARS. The Comptroller General translates STARS into Series Z and collects and processes other GAAP data on agency-prepared closing packages in order to produce its GAAP-basis financial statements. Both STARS and Series Z are table driven and for the financial statements to be accurate it is necessary that all the tables and translations be correct.

All federal grants and permanent improvement projects are assigned project numbers, which are four digit numbers. Recurring grants awarded by grant year maintain the same project number but retain their separate identity through the use of phase codes, which are two digit numbers that follow the project numbers. Together these six digit project/phase code numbers comprise the State's D38 table. When permanent improvement projects are funded by federal grants, the State uses a process to interrelate the grant and permanent

improvement project/phase codes. This process is described in the STARS Manual in Section 2.1.2.50.

For fiscal years 1998 and 1997, the Agency has not submitted accurate information in sufficient detail to the State to ensure that the project/phase codes are used properly. It has not interrelated its grants and permanent improvements as required by the State. Therefore, because the Comptroller General relied on this data, the State's financial statements are incorrect as they relate to the Agency. We could not determine the extent of the inaccuracies; however, we informed the auditors of the State's financial statements of the problem and also pointed out the significant size of the Agency.

The federal government assigns a catalog of federal domestic assistance (CFDA) number to most of its grants and cooperative agreements. The State requires each agency to provide the CFDA number for each grant when it obtains budgetary authority and approval for the grant. At this point, the State establishes the grant on the D38 table and also establishes a conversion table to relate D38 numbers and CFDA numbers. All documents submitted to the Comptroller General to be processed into STARS must include the project/phase code, if applicable.

Using the tables and the information provided on the transactions, the Comptroller General produces its CSA467 report which is a summary by project/phase code of cash, beginning fund balances, adjustment to beginning fund balances, revenues, and expenditures. The STARS Manual requires agencies to reconcile the CSA467 report to their books. See related findings in the comment, Reconciliations.

The State Treasurer is responsible for monitoring agencies' cash management and calculating interest receivable/payable under the federal Cash Management Improvement Act (CMIA). It uses data from STARS, including the project/phase codes and the translation to CFDA numbers to calculate cash balances by program. If these numbers and translations are inaccurate, then the interest calculations will also be inaccurate.

We noted that the Agency has significant errors in the translation of project/phase codes and CFDA numbers. Therefore, the State Treasurer's interest calculation is incorrect. Based on information provided by us, the State Treasurer requested the Agency to correct these errors in January 1999. On May 5, 1999, the Agency had not made the corrections.

We recommend that the Agency train its employees in the proper accounting of transactions and balances in SABAR, STARS, and GAAP-basis data provided to the Comptroller General. Also, we recommend that the Agency implement policies and procedures which ensure that all accounting data will be accurate, timely, and in compliance with all state and federal laws, rules, and regulations as well as with GAAP. The Agency should review the project/phase codes and CFDA numbers for each active grant and permanent improvement project and should make all the corrections needed. It should contact the Comptroller General and State Treasurer to determine what action is needed to correct errors that have already occurred.

SECTION B – STATUS OF PRIOR FINDINGS

During the engagements for fiscal years 1998 and 1997, we reviewed the status of corrective action taken on each of the findings reported in the Auditor's Comments section of the State Auditor's Report on the South Carolina Office of the Adjutant General for the fiscal year ended June 30, 1996, and dated September 27, 1996. We determined that the Office has taken adequate corrective action on the findings titled Armory Cash Receipts – Payments from Armory Rental Receipts, the first three errors noted in Payroll, Journal Entries, and Expenditure Object Codes. However, we have repeated the following findings:

Prior Auditor's Comments **Comment Title and Section**

GAAP Closing Packages – A

Armory Cash Receipts – A
Deposit of Armory Receipts

Deferred Revenue – A

Payroll - A (fourth error noted in comment)

Tuition Assistance Program - A

Current Accountant's Comments **Comment Title and Section**

Closing Packages - A

Revenues - A
Armory Receipts and Deposits
Unit Maintenance Funds - A

Deferred Revenues - A

Payroll - A

Tuition Assistance Program – A

MANAGEMENT'S RESPONSE

October 29, 1999

Mr. Tom Wagner
Office of the State Auditor
1401 Main Street, Suite 1200
Columbia, SC 29201

Dear Mr. Wagner:

It is a pleasure for me to forward to your office the Military Department of South Carolina's response to the State FY 1997-1998, Agreed Upon Audit Report. Our internal staff has completed an intense review of all findings. As a result of the considerable effort displayed by the Office of the State Auditor, and the Military Department's financial management staff this agency is better prepared to manage assets in the future.

Although the Military Department may not agree with all findings; we will work to ensure any inconsistencies and nuances that are reflective of our required Federal procedures are better coordinated in future audit reports. Reporting to both a State and a Federal entity are sometimes confusing and require additional study in audit inquiries. This agency appreciates the exceptional professional effort that the audit staff displayed while conducting their work within the Military Department.

Sincerely,

Stanhope S. Spears
Major General, SCARNG
The Adjutant General

Enclosure

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Internal Control

A viable internal control program is one that is designed to "reasonably ensure compliance" with laws, regulations, and program compliance requirements. One integral factor in the design of the process is the cost of the control as opposed to the potential loss or impact on the operating entity should the control, or lack thereof, fail to identify noncompliance.

As indicated in the audit report, there are essentially five components to an effective internal control program. We will address the auditor's comments as reported.

Control Environment

The organizational structure of the South Carolina Military Department is, for the most part, mandated by the Departments of the Army and the Air Force. The National Guard, by federal statute, holds a dual mission - one to protect and defend the constitution of the United States and to support the citizens of South Carolina before, during and after disaster operations. The fact that key members of the staff possess a strong military background is by design in that this is a military organization. While specific knowledge of and experience in state accounting is desirable, it is not as important to the overall mission as is federal or military experience.

"The loss of State experience has significantly impacted the finance department where familiarity with the State's accounting system and State laws, rules and regulations is essential" and the statement that "the Agency has lost key personnel who had a considerable amount of State experience" coupled with the "significant" number of audit findings covering the same period in which the "key person[nel]" served is perceived as a personal opinion. Your audit report suggests otherwise in that the "considerable" state experience did not necessarily equate to proper management of the finance department. State provided training would be an invaluable asset; however, during the conduct of this audit, we requested assistance from the audit staff in locating a source to provide training; our request could not be met as none exists.

Risk Assessment

As a point of fact, the individual cited as the permanent director was not so appointed as the report reflects. This individual was detailed into the position in an acting capacity until subsequent reassignment outside the finance department. The use of temporary employees in accounting functions as the cause of the conditions noted is not grounded in fact. Personnel assigned within the finance department, during the reporting period, more or less performed data entry functions and not true accounting activities. Our use of a temporary service to serve in administrative positions has no bearing on the condition of the finance department.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Control Activities

We are unsure of the situation in which reference to the decentralization of our accounting functions during the report period is made. Procedures, policies, and functional responsibilities did not change from prior audit periods. The observation that the "breakdown in controls occurred because of employee turnover in budget and finance" cannot be based on fact. Additionally, we are unaware of any mechanism which can be used to determine whether our Agency copies of the STARS Manual is current. We have requested new manuals.

Information and Communication

The Agency accounting system (SABAR) is used in at least eight other state agencies. SABAR provides information based on the State of South Carolina accounting system requirements. *If* a problem exists with available information, the problem is not the system. It is our experience that the problem existed in the reliance on the use of self-developed spreadsheets, provided by the former Director, as a mechanism to "translate" the state method of accounting to the federal employees. We have conducted both collective and individual training sessions with budget analysts and Program Directors.

The staffing of the Facilities Management Office is predominately state and not federal as indicated in the audit report. The use of testimonial evidence relating to open projects is not supported by audit findings. We cannot determine from the audit report whether the condition affecting the correct processing of project and phase codes was indicative of a systemic problem or a simple error.

Monitoring

The report seems to imply that the hiring of an individual as a resource manager caused a breakdown in the monitoring of the control process when the individual did not work, in part, for the state during the period of audit coverage. We hired this individual in late September 1997 and due to unforeseen requirements, she was utilized in organizing and preparing the Agency bid for a potential \$200 million dollar National Guard Cooperative Agreement with the United States Army and subsequently used in litigation issues. The employee assumed operational control of the finance department in June 1999.

Recommendations

Since June 1999, we have reassigned personnel and are in the process of developing new internal controls which will meet, at a minimum, the standards applicable to the federal programs. We have developed several performance indicators, established internal goals and objectives, and standards for individual performance. We will integrate this program into the control process. Additionally, we are currently reviewing each applicable internal regulation for possible changes and republication. We have scheduled additional Program Director, budget analyst, accounting, and procurement training to begin on 1 December 1999. This training is a joint effort between the USPFO and the State.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Since the reporting period, we have established several "Read-Only" accounts enabling our customers access to SABAR. We have also implemented the automated requisition module in SABAR; both programs provide customers with real-time accounting data. We are continuing to identify system requirements to our software provider.

Our attention to the monitoring component included reassignment of the Internal Review Division to the Chief of Staff office. The employee assigned will be scheduled for training as appropriate. We have identified to the USPFO and Army National Guard Chief of Staff the need for monthly Program Director meetings and have delayed said meetings pending legislative and presidential budget action.

Revenues

Armory Receipts and Deposits

The audit finding in this area reflects noncompliance with an administrative requirement which is locally mandated. The fact that deposits are not made on a specific day of the week does not indicate fraud, waste, or abuse of the program. Unit maintenance custodian duties are assigned as an additional duty to the full-time employees located at each armory. Delays in making deposits and forwarding documentation could have resulted from temporary duty assignments, deployments, or unit activation. We are currently reviewing AG Regulation 37-2, Financial Administration of Armory Operations Funds, for possible changes.

Coding of Revenue

Concur with recommendation to obtain and maintain current STARS Manual. Do not believe that the recommendation "that accounting transactions be reviewed independently before approval to ensure proper coding" is feasible. This constant level of supervision would be counter-productive and very costly.

Receipts and Supporting Documentation

No recommendation provided by audit staff.

Transaction Numbering

We are in the process of reviewing current policies and procedures as they relate to transaction numbering. We began using computer generated sequential numbering in lieu of manual numbering in July 1999.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Expenditures

Procurement Code

The newly assigned Procurement Officer has implemented a dual phase internal control to ensure compliance with the provisions of the South Carolina Consolidated Procurement Code, Section 11-35-1550.2(a) and 2(b). This process includes a review of required determinations at the time of submission of the purchase request and a subsequent review at the time of execution of the purchase order.

Expenditure Cutoff

The audit finding does not indicate when the invoice in question was submitted for payment. As provided in the audit report, the South Carolina Code of Laws, Section 11-35-45 requires submission of "vouchers for payment...within thirty work days from acceptance of the goods or services and proper invoice." Occasionally, we encounter vendors who invoice on quarterly cycles. We believe that we generally comply with Section 11-35-45.

Allocation of Costs

There is no statutory or regulatory requirement, beyond the National Guard Bureau approved budget, to document the predetermined funding ratio for the Army National Guard Telecommunications Appendix to the Master Cooperative Agreement.

Payroll

Concur with audit recommendation. We are currently developing procedures and policies which will provide verification of payroll information prior to processing. The Agency complies with the prescribed state pay period schedule.

Reconciliations

Reconciliation of accounts is now accomplished each month. The state accounts have been reconciled beginning in State Fiscal Year 2000 and the federal accounts will be reconciled starting in Federal Fiscal Year 2000. Discrepancies identified during this process will be researched and cleared in a timely manner.

Journal Entries and Transfers

Concur with audit recommendation. Journal entries will be prepared at the lowest possible level with supervisory review by the Comptroller. The Director of Resources approves comptroller prepared journal entries. Documentation necessary to support each journal entry will be attached to the journal entries.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Closing Packages

Concur with the audit recommendation. The newly assigned Comptroller has completed all required closing packages for the past fiscal year. File copies have been retained at the Comptroller level.

Deferred Revenues

Concur with the audit recommendation. The Comptroller will develop proper procedures applicable to deferred revenue. Required training will be conducted.

Unit Maintenance Funds

Petty Cash Checking Accounts

As with the audit observations associated with revenue reporting, the audit findings relating to account balances demonstrates an administrative shortcoming which will be amended during the revision of this program.

Contracted Services

The agency has retained counsel to research the issues raised by the auditor. The subject of worker classification (employee versus independent contractor) is an area subject to many interpretations. The September 1997 regulatory change was directed, based on the advice of the United States Property and Fiscal Office, to meet our business needs. Given that policy, we complied with the reporting requirements for non-wage payments as directed by the Internal Revenue Service. Upon advice of counsel, we will supplement our response as soon as their review is complete.

Workers' Compensation

Do not concur with audit findings or audit recommendations. Costs associated with workers' compensation premiums for members of the South Carolina National Guard and the South Carolina State Guard were correctly paid. These costs were appropriately determined in accordance with the South Carolina Code of Laws, 1976, as amended, Chapter 7.

Tuition Assistance Program

Legislative changes to the Tuition Assistance Program now require successful completion of approved courses prior to receipt of subject funds. The audit report states that this program is executed under federal control without mention of the state employee responsible for execution of this specific fund. As properly noted, both employees are under the control of the Adjutant General. We are confident in the execution of the program and have taken steps to correct past difficulties in the recovery of scholarship funds. The audit recommendations relating to establishment of records as liabilities is not feasible as the required military commitment beyond course completion makes this approach unmanageable. We are coordinating with our SABAR software provider to develop an accounts receivable module for reporting purposes.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Schedule of Federal Financial Assistance

Concur with audit recommendations. Personnel changes to the finance area should correct previously identified problems.

Public Assistance

Pass-Through Funds

Concur with audit recommendations. The newly assigned Comptroller will ensure adherence to State accounting practices and GAAP reporting regarding the establishment of subfunds in STARS and the GAAP funds to which they translate.

Reimbursed Funds

Concur with the audit recommendations; however, the auditor's perception of the reimbursements received is incorrect. The questioned reimbursements were: direct reimbursement for damage incurred during Hurricane Hugo, the auditor's source of information was incorrect in stating that the funds were "administrative fees"; the funds received for Hurricane Fran were for direct costs incurred by the Emergency Preparedness Division and are authorized to be retained by the Agency.

Cost Allocation Plan

Do not concur with audit recommendations or audit finding. The Direct Administrative Services Cost Plan is an allowable, allocable, ***direct*** cost plan, prepared in accordance with OMB Circular A-87, the provisions of the Master Cooperative Agreement, and Youth ChalleNGe Cooperative Agreement. This plan is approved by the cognizant federal agency and funded by the National Guard Bureau.

Permanent Improvement Project Accounting

Do not generally concur with audit finding. We believe that the audit staff may have relied on erroneous information rather than an informed review of the records. However, the newly assigned Director of Resources, in conjunction with the newly assigned Contracting Officer, newly assigned Comptroller, and the Facilities Management Officer are evaluating new procedures, policies, and internal controls as they relate to construction contracts.

South Carolina Military Department
Office of The Adjutant General
Agree-Upon Procedures Audit Report

Accounting System

We generally concur with the audit recommendations. We are working on program enhancements with the SABAR software provider to expand automated features not currently available, i.e., the automatic roll-forward function.

Data Translation to the State

Generally concur with audit recommendations. A comprehensive training program will be developed for all assigned personnel as well as available to external auditors.