

**SOUTH CAROLINA  
DEPARTMENT OF INSURANCE  
COLUMBIA, SOUTH CAROLINA**

**STATE AUDITOR'S REPORT**

**JUNE 30, 2007**

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# State of South Carolina



## Office of the State Auditor

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

May 28, 2008

The Honorable Mark Sanford, Governor  
and  
Mr. Scott Richardson, Director  
South Carolina Department of Insurance  
Columbia, South Carolina

We have performed the procedures described below, which were agreed to by the management of the South Carolina Department of Insurance (the Department), solely to assist you in evaluating the performance of the Department for the fiscal year ended June 30, 2007, in the areas addressed. The Department's management is responsible for its financial records, internal controls and compliance with State laws and regulations. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified parties in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and the associated findings are as follows:

1. **Cash Receipts and Revenues**

- We inspected selected recorded receipts to determine if these receipts were properly described and classified in the accounting records in accordance with the agency's policies and procedures and State regulations.
- We inspected selected recorded receipts to determine if these receipts were recorded in the proper fiscal year.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in the State's accounting system (STARS) as reflected on the Comptroller General's reports to determine if recorded revenues were in agreement.
- We made inquiries and performed substantive procedures to determine if revenue collection and retention or remittance were supported by law.
- We compared current year recorded revenues at the subfund and object code level from sources other than State General Fund appropriations to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that revenue was classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$377,800 - general fund, \$48,500 - earmarked fund, and \$18,000 - restricted fund) and  $\pm 10$  percent.

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- We performed procedures to ensure that revenue allocations were correctly distributed from the revenue clearing account to the various revenue accounts.

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Support for Receipt Transactions and Bail Bondsman Revenue in the Accountant's Comments section of this report.

2. **Non-Payroll Disbursements and Expenditures**

- We inspected selected recorded non-payroll disbursements to determine if these disbursements were properly described and classified in the accounting records in accordance with the agency's policies and procedures and State regulations, were bona fide disbursements of the Department, and were paid in conformity with State laws and regulations; if the acquired goods and/or services were procured in accordance with applicable laws and regulations.
- We inspected selected recorded non-payroll disbursements to determine if these disbursements were recorded in the proper fiscal year.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded expenditures were in agreement.
- We compared current year expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$32,800 – general fund, \$30,600 – earmarked fund, and \$18,100 - restricted fund) and  $\pm 10$  percent.

The individual transactions selected were chosen randomly. Our findings as a result of these procedures are presented in Travel Reimbursement and Payment of Invoices in the Accountant's Comments section in this report.

3. **Payroll Disbursements and Expenditures**

- We inspected selected recorded payroll disbursements to determine if the selected payroll transactions were properly described, classified, and distributed in the accounting records; persons on the payroll were bona fide employees; payroll transactions, including employee payroll deductions, were properly authorized and were in accordance with existing legal requirements and processed in accordance with the agency's policies and procedures and State regulations.
- We inspected selected payroll vouchers to determine if the vouchers were properly approved and if the gross payroll agreed to amounts recorded in the general ledger and in STARS.
- We compared amounts recorded in the general ledger and subsidiary ledgers to those in various STARS reports to determine if recorded payroll and fringe benefit expenditures were in agreement.
- We compared current year payroll expenditures at the subfund and major object code level to those of the prior year. We investigated changes in the general, earmarked, and federal funds to ensure that expenditures were classified properly in the agency's accounting records. The scope was based on agreed upon materiality levels (\$32,800 – general fund, \$30,600 – earmarked fund, and \$18,100 – restricted fund) and  $\pm 10$  percent.

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- We compared the percentage change in recorded personal service expenditures to the percentage change in employer contributions; and computed the percentage distribution of recorded fringe benefit expenditures by fund source and compared the computed distribution to the actual distribution of recorded payroll expenditures by fund source. We investigated changes of  $\pm 5$  percent to ensure that payroll expenditures were classified properly in the agency's accounting records.

The individual transactions selected were chosen randomly. Our finding as a result of these procedures is presented in Payroll in the Accountant's Comments section of this report.

4. **Journal Entries and Appropriation Transfers**

- We inspected selected recorded journal entries and all interagency appropriation transfers to determine if these transactions were properly described and classified in the accounting records; they agreed with the supporting documentation, the purpose of the transactions was documented and explained, the transactions were properly approved, and were mathematically correct; and the transactions were processed in accordance with the agency's policies and procedures and State regulations.

The individual journal entry transactions selected were chosen randomly. Our finding as a result of the procedures is presented in Journal Entries in the Accountant's Comments section of this report.

5. **General Ledger and Subsidiary Ledgers**

- We inspected selected entries and monthly totals in the subsidiary records of the Commission to determine if the amounts were mathematically accurate; the numerical sequences of selected document series were complete; the selected monthly totals were accurately posted to the general ledger; and selected entries were processed in accordance with the agency's policies and procedures and State regulations.

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

6. **Reconciliations**

- We obtained all monthly reconciliations prepared by the Department for the year ended June 30, 2007, and inspected selected reconciliations of balances in the Comptroller General's accounting records to those in STARS as reflected on the Comptroller General's reports to determine if accounts reconciled. For the selected reconciliations, we determined if they were timely performed and properly documented in accordance with State regulations, recalculated the amounts, agreed the applicable amounts to the Department's general ledger, agreed the applicable amounts to the STARS reports, determined if reconciling differences were adequately explained and properly resolved, and determined if necessary adjusting entries were made in the Department's accounting records and/or in STARS.

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We judgmentally selected the fiscal year-end reconciliation and randomly selected one month's reconciliation for testing. Our finding as a result of the procedures is presented in Reconciliations in the Accountant's Comments section of this report.

7. **Appropriation Act**

- We inspected agency documents, observed processes, and/or made inquiries of agency personnel to determine the Agency's compliance with Appropriation Act general and agency specific provisos.

We found no exceptions as a result of the procedures.

8. **Closing Packages**

- We obtained copies of all closing packages as of and for the year ended June 30, 2007, prepared by the Department and submitted to the State Comptroller General. We inspected them to determine if they were prepared in accordance with the Comptroller General's GAAP Closing Procedures Manual requirements and if the amounts reported in the closing packages agreed with the supporting workpapers and accounting records.

Our findings as a result of the procedures are presented in Legal Services and Depreciation of Intangible Assets in the Accountant's Comments section of this report.

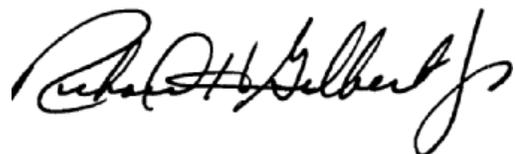
9. **Status of Prior Findings**

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

Our findings as a result of these procedures are presented in Section C in the Accountant's Comments section of this report.

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Governor and of the management of the South Carolina Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.



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

**ACCOUNTANT'S COMMENTS**

## **SECTION A - VIOLATIONS OF STATE LAWS, RULES OR REGULATIONS**

Management of each State agency is responsible for establishing and maintaining internal controls to ensure compliance with State Laws, Rules or Regulations. The procedures agreed to by the agency require that we plan and perform the engagement to determine whether any violations of State Laws, Rules or Regulations occurred.

The conditions described in this section have been identified as violations of State Laws, Rules or Regulations.

## **RECONCILIATIONS**

During our review of the Department's reconciliations, we noted the following deficiencies:

1. Cash reconciliations were not prepared.
2. Expenditure and revenue reconciliations for several months were not consistently signed by both the preparer and the reviewer.
3. Several FM13 cash and revenue accounts did not agree to the Comptroller General's reports. The Department could not explain the variances.

According to the Department, because of changes in the Administration staff during the fiscal year, reconciliations were not consistently prepared. The Department also stated a reconciliation of cash was unnecessary.

Section 2.1.7.20 of the Comptroller General's Policies and Procedures Manual (STARS Manual) requires that all agencies perform regular monthly reconciliations of revenues, expenditures, federal programs, and ending cash balances between their accounting records and those in STARS in order to timely detect and correct errors. These reconciliations must be performed at least monthly on a timely basis, be documented in writing in an easily understandable format with all supporting workpapers maintained for audit purposes, be signed and dated by the preparer, and be reviewed and approved in writing by an appropriate agency official other than the preparer.

We recommend the Department develop and implement procedures to ensure that reconciliations are performed in accordance with applicable State regulations.

## **PAYMENT OF INVOICES**

During our Test of Disbursements, we noted that one voucher out of 25 tested was not submitted to the Comptroller General's Office for payment within 30 days of receipt of goods and/or services. We also noted this same exception for two vouchers out of 25 tested in our Cut-Off Test of Expenditures. The two vouchers were also not paid in the correct fiscal year. The original invoices were held by other departments and were not forwarded to the finance department in a timely manner, causing a delay in payment.

Section 11-35-45 of the 1976 South Carolina Code of Laws, as amended, requires payment of goods and services within 30 workdays of the receipt of goods and/or services.

We recommend the Department implement procedures requiring that invoices be forwarded directly to finance upon receipt. We also recommend the Department instruct its departments to notify finance of the acceptance of goods and services to ensure timely payment.

## **TRAVEL REIMBURSEMENT**

### **Mileage Reimbursement**

The Department uses a conversion formula approved by the Comptroller General's Office to reimburse insurance examiners for mileage incurred during examinations because the National Association of Insurance Commissioners (NAIC) allows a higher mileage rate than the maximum rate allowed by the State's travel regulations. During our Test of Disbursements, we noted that for four of the 25 vouchers tested, the Department did not document this conversion formula on the travel voucher; therefore we could not determine the actual miles incurred by the examiner or if the converted miles were calculated accurately.

Effective internal controls require the Department maintain accurate documentation to support all calculations.

We recommend the Department ensure that personnel responsible for approving travel vouchers perform careful reviews of the vouchers before approving the travel reimbursement. The Department should also implement policies and procedures to ensure that the conversion formula is properly documented on the examiners' travel vouchers.

### **Travel Voucher**

During our Test of Disbursements we noted that for one voucher out of 25 tested, a \$12 reimbursement for meals was posted to object code 0501, In-State Meals-Non-Reportable, but should have been posted to object code 0520, In-State Meals – Reportable, because the employee was not in travel status overnight.

State travel regulations specify that, receipts for all expenditures, except for taxis and meals, shall be attached to the voucher. Also, the STARS Manual requires object code 0520 be used for in-state meals when an employee travels on a single calendar day trip.

We recommend the Department ensure that personnel responsible for approving travel vouchers be familiar with State law regarding travel regulations and perform careful reviews of the vouchers. In addition, we recommend the Department strengthen its policies and procedures to ensure vouchers are properly coded and recorded in its accounting system.

## **LEGAL SERVICES**

The Department paid for certain legal services that were not authorized by the South Carolina Attorney General's Office (AGO). The Department submitted a "South Carolina Attorney General Request for Authorization to Employ Associate Counsel" form to the AGO requesting approval of attorney services for the period July 1, 2006 through June 30, 2007 on August 15, 2006.

The AGO approved the request on August 29, 2006. The AGO approved a maximum compensation of \$40,000. We determined that the Department paid legal fees totaling \$48,507.

Proviso 32.3 of Part 1B of the 2006-2007 Appropriation Act states that no department or agency of State Government shall engage on a fee basis any attorney at law except upon written approval of the Attorney General and upon such fee as shall be approved by him.

We recommend the Department establish policies and procedures to ensure that it adheres to the rates approved by the South Carolina Attorney General's Office. We also recommend the Department monitor its procurements to ensure that it does not exceed the approved procurement limit and if necessary to request approval for expansion of services and/or increased fees.

## **PAYROLL**

### **Documentation of Hourly Rate**

We could not locate documentation in the employee's personnel file to support the hourly rate paid to one of the 25 employees tested in our Test of Payroll.

An effective system of internal controls includes control procedures to ensure the Department prepares and maintains proper and adequate documentation in its employee files to support all personnel transactions.

We recommend that the Department develop and implement procedures to ensure that information pertaining to employees' pay is properly maintained.

### **Justification of Salary Increase**

For one of the 25 employees tested in our Test of Payroll, the Department could not provide documentation supporting a .48% salary increase.

State Human Resources Regulation 19-705.04 states that written justification for awarding an in-band salary increase shall be maintained by the employing agency.

We recommend the Department adhere to all State human resources laws and regulations including those covering salary increases.

### **DEPRECIATION OF INTANGIBLE ASSETS**

During our test of the capital assets closing package, we noted that the Department assigned a useful life of seven years to two intangible assets (computer software). The Comptroller General's GAAP Closing Procedures Manual (GAAP Manual) instructions specifies that externally acquired computer software with a cost of \$100,000 or more be depreciated using a useful life of three years. Because the Department assigned the assets a seven year life depreciation expense was overstated by \$149,925 and accumulated depreciation was understated by \$375,513. Furthermore, the assets were purchased in 2003 and 2004 and therefore should have been fully depreciated before fiscal year 2007.

We recommend the Department implement policies and procedures to ensure assets are properly depreciated and reported on the capital assets closing package in accordance with GAAP Manual instructions. We also recommend the Department make the necessary corrections to its fiscal year 2008 capital assets closing package.

## **SECTION B - OTHER WEAKNESSES**

The conditions described in this section have been identified while performing the agreed-upon procedures but are not considered violations of State Laws, Rules or Regulations.

## **JOURNAL ENTRIES**

During our test of journal entries we noted 24 out of 25 journal entry documents tested did not contain evidence of proper approval. According to Department personnel, there is no formal policy regarding approval of journal entry documents. Additionally, the Department could not locate one of the journal entries we selected for testing.

Effective internal controls require adequate review of all transactions including adjustments. The review should be performed by persons knowledgeable of generally accepted accounting principles. Controls should also be in place to ensure that documentation is retained and filed in an orderly manner to support all recorded transactions.

We recommend the Department take appropriate action to ensure journal entries are reviewed and approved in writing prior to posting. The Department should also implement procedures to ensure proper safeguarding and accountability of documents.

## **SUPPORT FOR RECEIPT TRANSACTIONS**

The Department could not provide us with documentation to support 3 out of 25 receipt transactions tested in our Test of Cash Receipts. Therefore, we were unable to determine if the revenue was deposited in a timely manner or if the amount of revenue received was in accordance with Department regulations.

Effective internal controls include controls to ensure supporting documentation is maintained to support all recorded transactions.

We recommend the Department establish policies and procedures to ensure that documents can be located at all times by authorized users, as necessary.

## **BAIL BONDSMAN REVENUE**

The Department receives revenue for bail bondsman and runner licenses. This revenue is first recorded into a decentralized receipts system and then into the BARS accounting system by batches. During our review of this revenue account we noted that the total revenue recorded in the decentralized system did not agree to total revenue recorded in BARS or posted to the Comptroller General's CSA 406 report. Therefore we were unable to determine whether revenue had been recorded accurately in the Department's book of record.

According to Department personnel, former employees attempted to reconcile the two systems but were unable to determine why the difference occurred.

Sound internal controls require revenue be properly recorded in the Department's books. The decentralized system utilized by the Department should be reconciled at least monthly to the Department's BARS accounting system.

We recommend the Department strengthen its policies and procedures to ensure its receipts system is regularly reconciled to its accounting system and if necessary, document and correct any differences noted during the reconciliation process.

## **SECTION C - STATUS OF PRIOR FINDINGS**

During the current engagement, we reviewed the status of corrective action taken on each of the findings reported in the Accountant's Comments section of the State Auditor's Report on the Department for the fiscal year ended June 30, 2006, and dated August 9, 2007. We determined that the Department has taken adequate corrective action on the findings regarding Fidelity Bond Approval and Support for Procurement Card Purchases. We determined the other deficiencies described in our prior report still exist; consequently we have repeated similar findings regarding Payroll and Journal Entries in Section A and Section B therein.

**MANAGEMENT'S RESPONSE**



# South Carolina Department of Insurance

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**MARK SANFORD**  
Governor

**SCOTT RICILARSON**  
Director of Insurance

July 30, 2008

Mr. Richard H. Gilbert, CPA  
Deputy State Auditor  
Office of the State Auditor  
1401 Main Street, Suite 1200  
Columbia, S.C. 29201

Dear Mr. Gilbert:

The South Carolina Department of Insurance has reviewed the draft copy of the FY 2007 Agreed-Upon Procedures engagement and wishes to offer the following response:

## Reconciliations

### 1. Cash Reconciliations:

The Department of Insurance (DOI) operates on the cash basis of accounting. In a cash basis system, the only transactions that effect cash are revenues and expenditures. The previous Finance Director changed the monthly reconciliation process from one that balanced at the object code level to a more detailed procedure that matched individual transactions. This process identified individual reconciling items and provided much more information. The DOI receives hundreds of thousands of individual payments each year so the monthly reconciliation of revenues creates extensive work papers and Excel worksheets. To combine this detail with individual items arising from the expenditure reconciliations would have created an unmanageable document. The reconciliation of revenues and expenditures identified all items that effect cash so no business purpose would be achieved in combining all these elements into one large reconciliation.

No further work is required by DOI as the agency was in the first wave of State agencies to implement SAP as part of the SCEIS project so cash reconciliations are no longer required.

### 2. Reconciliation Signatures:

DOI concurs that reconciliations were not consistently signed by the preparer and reviewer. All reconciliations were reviewed by the Finance Director.

It should be noted that DOI was in the first wave of State agencies to implement SAP as part of the SCEIS project so reconciliations are no longer required.

3. Account Reconciliations:

DOI personnel performed extensive procedures in an effort to identify these variances. All of these procedures were documented in memo form, copies of which were provided to the Audit staff. DOI processes hundreds of thousands of transactions each year making the identification of small variances very difficult. Subfund 3041 is a clearing account that is closed to a zero balance at the end of the fiscal year. Detail transactional information on this subfund does not appear on the various STARS reports so locating reconciling items were not possible. The combined revenue variance in the three subfunds involved accounted for .3% of revenues collected for those subfund/object code combinations and .04% of total revenues collected by the Department.

DOI was in the first wave of State agencies to implement SAP as part of the SCEIS project and reconciliations are no longer required.

**Payment of Invoices**

DOI noted the issue when it occurred at the end of FY 07 and management notified agency staff by email to not hold invoices. DOI management has informed staff that invoices are to be submitted for payment within 30 days.

**Travel Reimbursement**

1. Mileage Reimbursement

The Comptroller General does not require the inclusion of the NAIC formula on travel vouchers submitted by our examiners. DOI examiners have used the mileage conversion in accordance with NAIC guidelines for many years without inclusion on the travel voucher so DOI is uncertain as to why this is an issue in the FY 07 AUP audit. DOI has requested that Examination staff begin including the mileage conversion calculations on each travel voucher.

2. Travel Voucher

The Department concurs that the \$12 for the single meal was charged to the incorrect object code. It should be noted the voucher was approved and paid by the Comptroller General's Office.

**Legal Services**

DOI concurs that funds were over expended in accordance with the original Form 1 approved by the Attorney General's Office. However, DOI submitted an amended Form 1 that included the expenditures in question. This Form 1 has been approved by the Attorney General's Office so all attorney expenditures from FY 07 have been approved. DOI has instituted new procedures to monitor attorney expenditures.

**Payroll 1.**

1. Documentation of Hourly Rate

DOI concurs that documentation for the employee's hourly rate could not be located. It should be noted that the employee had worked for DOI previously and was returning to DOI at the same hourly rate. DOI will be more diligent in preparing and retaining proper documentation.

## 2. Justification of Salary Increase

DOI concurs that documentation could not be located to justify the .48% salary increase. DOI will be more diligent in preparing and retaining proper documentation.

## Depreciation of Intangible Assets

DOI concurs the assets were depreciated using the incorrect useful life. The useful lives for these assets were established several years ago and DOI assumed they were being depreciated correctly since they have been subject to several audit cycles with no findings. These assets are our most material in terms of original cost. DOI assets have been loaded into SAP and DOI has made modifications to the asset's useful lives so they will be fully depreciated at the end of FY 08.

## Journal Entries

### 1. Approval

DOI concurs that journal entries did not contain evidence of approval. DOI participated in the first wave rollout of SAP as part of the SCEIS project. SAP utilizes a workflow process that electronically sends journal entries to the Deputy Director for approval. While signatures are not present, the workflow system records each step in the process.

### 2. Missing Entry

The purpose of the missing journal entry was to cancel a contingent voucher. DOI procedure in this instance would be to make a screen shot of the entry for use as supporting documentation. DOI could not locate the original entry but did provide SAO staff with a screen shot of the entry in question. DOI also provided SAO staff with copies of subsequent related entries and an explanation of the chain of events that lead up to the voucher deletion. While the original piece of paper could not be located, more than enough supporting documentation was provided to explain the purpose of the entry. DOI will be more diligent in document retention.

## Support for Receipt Transactions

During FY 07, DOI embarked on an extensive imaging project to electronically catalog millions of pieces of paper related to licenses and central files. DOI imaged an estimated 10 million sheets of paper in an effort to make document storage more affordable and efficient. DOI has been unable to locate two of the form related to appointments. DOI has recently located the one form pertaining to Bail Bondsman licensing and provided the same to SAO personnel.

## Bail Bondsman Revenue

DOI has determined that the variance of \$200 is the result of the misclassification of a transfer from the end of FY 07. Revenues for Bail Bondsman per the BARS system used by DOI agreed with revenues per STARS. DOI reconciled the cash receipts system to the BARS system on a monthly basis. The variance of \$200 represented .24% of the \$81,440 in Bail Bondsman revenues.

Mr. Richard H. Gilbert, CPA  
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The Department of Insurance authorizes release of the final report to include our responses noted above. Please feel free to contact me anytime at 737-6343.

Sincerely,

A handwritten signature in black ink, appearing to read "Benjamin Duncan", with a long horizontal line extending to the right from the end of the signature.

Benjamin Duncan  
Deputy Director for Administration

BD/jde

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